S. HRG. 99-565

RENEWAL OF THE EXPORT-IMPORT BANK ACT OF 1945

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

SECOND SESSION

ON

THE CONSIDERATION OF LEGISLATION ON UNFAIR EXPORT FINANCING COMPETITION THAT HARMS U.S. EXPORTS. GOVERNMENTS AROUND THE WORLD OFFER SUBSIDIZED FINANCING TO FOREIGN BUYERS WHICH DISTORT PURCHASING DECISIONS IN THE INTERNATIONAL MARKETPLACE

FEBRUARY 7, 1986

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RENEWAL OF THE EXPORT-IMPORT BANK ACT OF 1945

FRIDAY, FEBRUARY 7, 1986

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY,

Washington, DC.

The subcommittee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building; Senator John Heinz (chairman of the subcommittee), presiding.

Present: Senators Heinz, Mattingly, D'Amato, Proxmire, and Sasser.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. The subcommittee will come to order.

Today the subcommittee begins consideration of legislation to reauthorize the charter of the Export-Import Bank.

I do not need to elaborate on the need to improve the U.S. trade performance. The 1984 trade deficit of $123 billion was a record that, unfortunately, lasted only until the 1985 deficit of $148.5 billion that was announced last week.

As previous hearings before this subcommittee have shown, the dollar misalignment has been a big contributor to the trade deficit, as has slow economic growth in many other parts of the world.

Even as these situations improve, however, we are still faced with unfair export financing competition that harms U.S. exports. Governments around the world continue to offer subsidized financing packages to foreign buyers, winning sales as a result of export credit subsidies that distort purchasing decisions in the international marketplace.

The most effective way to correct these distortions is to counter them with fully competitive Eximbank financing. With an effective Eximbank which neutralizes the impact of foreign credit subsidies, the level and structure of U.S. exports can be determined by market forces, such as price, quality, and service. Without Exim, the United States is putting its fate in the hands of its competitors.

Given Exim's unique contribution to our economy, I must express my concern about the renewed effort to replace the proven Direct Lending Program with an Interest Rate Buydown Program, the so-called I-Match.

Clearly, the administration is making a sincere effort to iron out the technical problems in last year's proposal and to develop a

workable Interest Rate Subsidy Program [I-Match] at least in the short run.

However, these technical problems have been resolved at the cost of some increasingly complicated administrative procedures.

Indeed, trying to understand how to make I-Match work reminds me of the warning from Sir Walter Scott: "Oh, what a tangled web we weave, when first we practice to deceive!"

No matter how many technical improvements are made to I-Match, two problems can never be resolved.

First, I-Match will increase the real economic cost of providing export credits, as Exim's cost of borrowing from and making direct transfer payments to U.S. banks exceeds by tens of millions of dollars the cost of raising funds through the Treasury.

Second, these transfer payments will be drawn from the Bank's reserves and capital and will sap Exim's financial vitality.

I-Match is a funding mechanism that is damaging to the Bank and misleading to the public. Exim's apparent budgetary cost will be greatly reduced, yet its underlying effect on the capital markets will remain essentially the same, but the economic cost of the program will rise due to the higher borrowing costs.

Yes, there will be a budget savings on paper, while in fact we will be making Government costs more.

The problems with I-Match highlight for us the need to devise appropriate budgetary rules for Exim, rules which allow the Bank to continue providing support in the least expensive and most efficient way while accurately reflecting its true impact.

We don't have that under the current procedures, and we don't have it with I-Match either.

Clearly, the administration believes Exim is an essential part of our efforts to combat foreign trade subsidies. Only an essential program could convince OMB to go through this degree of gimmickry to protect the program from budget cuts.

Therefore, why not give the Bank the budget protection it deserves by removing Exim direct lending from the unified budget?

By taking Exim direct loans off budget cleanly and smoothly—rather than through the tortuous mechanism of the I-Match Program—the Bank could continue to provide support in the most economical and efficient manner possible through the tried and effective direct lending programs.

For most of its history, the Bank's direct lending has been off budget. It certainly makes more sense to do that than to treat its loans as grants, which they are not, or to pretend that the Bank isn't making direct loans when it subsidizes the guaranteed loans from commercial banks, as provided for in I-Match.

In addition to reviewing the I-Match proposal, this hearing will address the degree to which Exim is meeting the competitiveness mandate given to it in no uncertain terms by Congress in 1983. I note that Exim activity continues to decline, and I want to ascertain how much of that decline is due to certain persistently uncompetitive features of Exim programs rather than to the drop in demand for our products.

As long as official export credit subsidies are part of the international competitive scene, U.S. exporters—and the U.S. economy—deserve nothing less than a competitive and efficient Eximbank.

The need for Exim goes beyond increased exports and additional jobs. It goes to the very core of our economic system.

By neutralizing the effect of foreign export credit subsidies, the United States can restore the power of market forces to the international marketplace. By creating that kind of level playing field, as President Reagan said on Tuesday, American exports can compete with anyone.

Before we turn to our first witness, Bill Draper, I want to recognize the presence of my good friend and colleague from Georgia, Senator Mattingly.

Senator Mattingly, do you have a statement?

Senator MATTINGLY. Thank you, Mr. Chairman.

I appear to be the only other member of the committee that made it through the ice today.

I do have a statement for the record, so I won't read mine. I will make it part of the record, and any questions I will have you all respond to in writing, as I have another meeting after this one.

Two additional, comments: In reference to I-Match, I see the bottom line as making certain that it is not done at the expense of U.S. exporters or the U.S. taxpayers and while it may or may not be brought up here today, I am concerned, about Eximbank loans to Angola, and whether final disbursements are actually going to be made.

I'm wondering what is the position of the Eximbank toward any future loans? I hope that there wouldn't be any.

I am eager to hear all you have to say this morning, Bill.

Thank you, Mr. Chairman.

Senator HEINZ. Senator Mattingly, let history record that the people of Georgia are represented by somebody which neither rain, nor sleet, nor snow, nor icy roads would withhold from his important duties——

Senator MATTINGLY. The reason why I am leaving so soon is to go back there where it is warm and there isn't any snow. [Laughter.]

[The complete prepared statement of Senator Mattingly follows:]

OPENING STATEMENT OF SENATOR MATTINGLY

Thank you Mr. Chairman. I want to thank the witnesses for taking the time to be with us today, especially Bill Draper. Bill, I understand that this could well be your farewell appearance before this subcommittee and I want to wish you the best of luck. In my experience you have always been forthcoming and informative in an area critical to U.S. exporters: Export finance. The situation has continued to worsen for U.S. exporters. Long overdue action on the Federal budget will in all likelihood force us to rethink our export financing policies and programs. While I remain to be convinced that the "son-of-I-Match" you are proposing today is the answer, I, and, I think, most of my colleagues are willing to acknowledge that we must consider alternative means for financing our exports.

Mr. Chairman, under the terms of Gramm-Rudman-Hollings we will reduce and eventually eliminate the Federal budget deficit. The President has submitted his fiscal year 1987 budget, the first under Gramm-Rudman-Hollings, and in that budget Eximbank

direct loans are replaced by an Interest Rate Subsidy Program. The administration thus hopes to achieve a savings of $4.6 billion in budget authority and $1.9 billion in outlays over the period 1987 through 1991. Frankly, I appreciate the effort made by the Bank to address concerns raised over the original I-Match Program as contained in the 1986 budget. However, I remain concerned as to the long-term viability of the Bank under this or any program. I am convinced that serious change is needed, but do not want to see it at the expense of U.S. exporters or U.S. taxpayers.

Senator HEINZ. Senator Mattingly, thank you very much. It is a pleasure and honor to welcome William H. Draper III, the President and Chairman of the Eximbank.

I would say, by the way, that this may be Bill Draper's last appearance before this committee in this capacity. He is going on to bigger and better things, at least if that is possible, as hard as it is for us to believe that anything is bigger and better than the Export-Import Bank. He is going to the U.N. Development Fund [UNDF], we believe.

Bill, it is very good to have you here, and this is not the twilight of your career; it is just one of the last appearances on behalf of Exim. We feel that you will star at the UNDF equally.

Welcome.

STATEMENT OF WILLIAM H. DRAPER III, PRESIDENT AND CHAIRMAN, THE EXPORT-IMPORT BANK

Mr. DRAPER. Thank you very much, Mr. Chairman.

I should point out that I haven't yet been nominated, and that requires the nomination of the Secretary-General and final approval through the General Assembly.

I am looking forward to the new possibility of running that UNDF. It is not bigger and better; it is just different from the Eximbank, which of course I have been delighted to have had the opportunity to lead in the last 5 years and have particularly enjoyed getting your support and that of the rest of the committee.

I might say that it is indeed peak or, as you put it, it isn't the termination of a career, but sometimes it seems that way. I look at your dark hair, and it hasn't changed. You haven't got one gray hair, and when I first came 5 years ago and met with you, I didn't either. [Laughter.]

Now, I have 14,200 gray hairs.

Senator HEINZ. I hope you don't attribute your maturing simply to appearing before this committee. [Laughter.]

Mr. DRAPER. Mr. Chairman, members of the committee, I am pleased to appear before you today to ask your support for proposed amendments to the Export-Import Bank Act of 1945 as amended.

We are asking you to extend the life of the Bank for 5 years, through fiscal year 1991. And we are asking for authority to institute an Interest-Matching Program, which you mentioned, to buy down private sector interest rates to Organization for Economic Cooperation and Development [OECD] minimum rates.

I would also like to speak in support of legislation to establish a $300 million mixed-credit war chest.

REQUEST 5-YEAR EXTENSION FOR EXIMBANK

Our first request is that you extend the life of the Bank for 5 years to September 30, 1991. This will give the Bank reassurance of continuity and allow us greater flexibility in planning programs and setting policies to support the American exporter.

Since the Bank's charter was last extended, Eximbank has been making improvements in our programs at the rate of one a month. Just last month, we increased our long-term financing coverage to 85 percent of the export value—the maximum allowed under OECD arrangement rules.

On January 15, we were the first one to announce a drop in our lending rates—by 1.05 percent—to correspond to the new minimum levels allowed under the OECD arrangement.

Let me talk a little bit about these OECD concensus rates and how the international agreements we have negotiated governing these rates have affected our business.

When I came to Eximbank in 1981, we were heavily subsidizing exports by borrowing money at around 15 percent and relending it at 8¾ percent. Our competitors were lending at even lower rates—100 basis points below, on the average.

Eximbank led the way in raising export credit rates to near market levels and our competitors followed until January 1983, when we dropped our rates to a fully competitive level.

In October 1983, we agreed with our OECD counterparts to make export credit rates to market rates and to automatically make adjustments on a periodic basis to reflect changes in market rates.

We have recently conducted a detailed analysis of the disposition of contracts on which Eximbank has offered direct credits. The facts show that we are very competitive. Our analysis covers fiscal year 1983 through fiscal year 1985 and the total comes to $15.1 billion.

Of this total, preliminary commitments for $4.6 billion were canceled because the project or purchase was dropped or deferred for an indefinite period by the buyer.

Of the $10.5 billion in financing that has gone forward, the United States has won nearly half the business. That's an amazing statistic considering the high value of the dollar during this period. What is more, nearly half of those U.S. orders were financed from the private sector—or with our financial guarantee—but without any direct lending from Eximbank, even though we had offered OECD minimum rate financing.

In fiscal year 1985, 80 percent of the total orders won by U.S. suppliers where we had agreed to support the sale with Eximbank bank credits proceeded with private financing instead. This is the principal reason for the low utilization of our direct credit authority in fiscal year 1985.

CUT SUBSIDY ELEMENT DRAMATICALLY

So, in winning agreement to peg export credit rates closely to market rates, we have cut the subsidy element dramatically—and we have accomplished our stated purpose, which is to put the financing of exports more and more into the private sector.

Now, what about the orders lost to foreign competition?

Well, in every case where the U.S. exporter loses the order, we ask them why they lost. Here's what happened, based on those exporter reports.

During the same 3-year period, 93 percent of the losses were due to price or other nonfinancial reasons, generally reflecting the high value of the dollar. During 1984-85, none of this business—I repeat, none of this business—was considered by the exporter to be lost because Eximbank was not competitive with OECD level financing.

However, 6 percent of the total losses were due to foreign concessional aid—mostly mixed credits or tied aid. This remains a loophole in the concensus and we are working to close that loophole, a matter I will address later in my testimony.

But, as recently as at breakfast this morning with the OECD negotiator from Europe, we are still working on that problem.

We think these figures dramatically demonstrate our competitive strength against subsidized foreign competition. American exporters have cut costs and improved efficiency in the face of a high dollar. Now, as the dollar weakens, we are confident that exports will accelerate and our $148.5 billion trade deficit will begin to shrink.

As I have indicated, lending is only one aspect of Eximbank's operations. A far larger proportion of our business is in the area of risk protection—credit insurance guarantees.

It is particularly in the area of risk taking where Eximbank has led all other nations. We have supported American exporters in country after country where our competition has bowed out. During the international crisis of confidence, we stayed wide open in Mexico, when such nations as Japan, Germany, and France stopped doing any business at all and are still cautious.

In Brazil, the world's most heavily indebted nation, Eximbank stayed open in all its programs while Japan, Britain, and Canada all closed down.

We have been able to take the leadership role in risk assumption during this period because Eximbank takes the long-term view of the resource-rich debtor nations. We view their problems as those of illiquidity rather than insolvency. And in so doing, we have kept trade lines open for U.S. exporters.

In the past 2½ years we have greatly enhanced our insurance and guarantee programs. Most of the changes we have made in these programs are aimed at specifically increasing their attractiveness to small- and medium-sized business.

SUPPORTIVE OF SMALL BUSINESSES

Again, in fiscal year 1985 we exceeded our set-aside requirements in support of small business. Congress legislated an 8-percent set-aside for last year. However, 13 percent of Eximbank's total authority was devoted to small business, and over 20 percent of the business we actually did was for small business.

Eximbank has a major communication and marketing effort to reach small businessmen around the Nation. We plan to continue this effort.

For fiscal year 1987, the President will propose giving Eximbank interest-matching authority to support privately funded loans of up

to $1.8 billion. That's an increase of around $700 million from the direct lending authority for fiscal year 1986.

He will also be requesting a total insurance and guarantee authority of $12 billion, which is the same as our pre-Gramm-Rudman level for this year. This authorization includes up to $1.8 billion in I-Match guarantee authority.

The I-Match II Program will make a substantial positive contribution to reducing the budget deficit. Under our present Direct Lending Program we have to use our cash inflow or borrow the money we lend in support of U.S. exports. These loans count as budget outlays just as if they were payments for salaries, rent, postage, or other unrecoverable expenses.

No private business could succeed under that kind of accounting program.

Under the I-Match II Program, only the subsidy element and the interest rate on those loans hits the budget. And that's as it should be.

Now, let me tell you how we have improved the Interest-Matching Program since it was first proposed for 1986. Our enhanced I-Match II Program draws in a much broader section of the financial community to the funding operation.

We listened to the concerns the financial institutions raised last year. And in developing I-Match II, we are addressing those concerns. And before putting forth our present program, we invited bankers—those from trade, finance, and other capital market side—from small- and medium-sized banks to give us their views. The views have been valuable in helping us develop I-Match II.

I am confident in stating we have overcome the misgivings they had about I-Match I.

We approved the assignability feature of our guarantee to make an I-Match loan an attractive and marketable instrument. We solved the warehousing problem—eliminating the interest rate risk between the funding of a loan and the actual disbursements. We have provided for a one-time drawdown from the lender.

In our Medium-Term Program we are not requiring banks to take a fixed-rate risk over the life of the loan. We are adjusting the interest rate subsidy every 6 months in line with market rates for 6-month funds.

This is a major concern of the Bank under the Medium-Term Program and we have eliminated that concern.

In addition to working closely with bankers we have sought the advice of a wide range of exporters and incorporated their suggestions as well. I think we have demonstrated to their satisfaction that I-Match II is technically sound.

$300 MILLION WAR CHEST

Finally, I would like to ask your support for another piece of pending legislation: The establishment of a $300 million war chest in the Treasury Department for purposes of assisting negotiations for much greater restrictions on the use of tied-aid credits to support commercial export sales. This war chest would be able to finance over $1 billion of U.S. exports because the funds would be

blended with standard Eximbank export credits in a ratio of one part grant to three or four parts standard export credits.

The President intends to request appropriations for this fund for fiscal year 1987 and we consider congressional backing essential for our negotiating position.

As you know, the U.S. Government has been pressing our OECD counterparts to raise the level of the minimum grant element in tied-aid credits from 25 to 50 percent. At the President's direction we have already begun, inside the Eximbank, an aggressive campaign of targeted mixed-credit action where we feel it will have the maximum impact on negotiations. It is directed against those countries that have been impeding those negotiations.

Since adoption of our more aggressive policy last autumn, we have made eight offers of mixed credits. That is, we have offered to combine one of our normal export credits with either a low-interest, long-term loan from our own resources or else a grant from the war chest when that money becomes available.

In some cases, we surprised our competition by making mixed-credit offers in the traditional markets of these countries where they have previously not found it necessary to offer concessionary financing.

Or, in cases where they have outstanding mixed-credit offers, we have made even more concessionary offers in support of American exporters.

Two weeks ago I was in Paris at negotiations with other OECD export credit agencies. The meeting was productive by clearly pointing out that most of the 22 countries support increased curves on mixed credits.

For example, the Japanese arrived at taking the position that there should be an immediate and significant increase in the minimum grant level. Almost every other country outside the common market took a similar position. And many countries within the European community also supported us.

We feel there is certainly a majority inside the common market as well that supports us. I hope that these encouraging signs point to a satisfactory agreement this spring, but they may not.

Until we have an agreement signed, sealed, and delivered, we need to keep the pressure up, which means we need favorable action on the war chest legislation.

Thank you very much, Mr. Chairman. I will be happy to answer any questions you may have.

[The complete prepared statement follows:]

Senator HEINZ. Thank you very much. I have some questions I want to ask you, but before I ask those questions, I want to recognize Senator D'Amato and Senator Sasser for any opening statements which they may wish to make at this point.

Senator D'Amato.

Senator D'AMATO. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR D'AMATO

First, let me commend you for your activity in this area because I am certain, without your invaluable leadership Exim may not exist today. You have taken on those forces that sought short-term gain, that didn't look to the long term, that did not see how important Exim is, and who sought to take advantage of the fact that the American public in many cases may not realize that the prudent investment of some dollars which make available loans, that assist our trading partners and ourselves. Further, through the Eximbank we have substantially reduced the great trade deficit that exists and could have been even greater.

So, Mr. Chairman, I would like to commend you, the work of this committee, and your leadership in this area.

Mr. Chairman, I would also like to commend William Draper III, who is resigning as President and Chairman of the Board of Eximbank on February 28. He has been an articulate advocate and has done an outstanding job over these past 5 years and not during an easy time.

And let me wish him well. You are needed in the United Nations. [Laughter.]

Senator HEINZ. I think he also will become a constituent.

Senator D'AMATO. Well, that is why I [laughter]. Will you register by November? [Laughter.]

Senator HEINZ. They may well need every Republican they can get.

Senator D'AMATO. Mr. Chairman, to look at Exim—and if I might just for several minutes—since its creation in 1934, the Eximbank has assisted more than $180 billion in U.S. exports through various loan guaranteed programs, and I guess the figure, if I am not mistaken, generally say about 1 billion dollars' worth of exports creates or retains about 40,000 jobs, is that right?

So every $1 billion we do in exports, we are talking about the potential of creating or retaining some 40,000 American jobs.

And this is a program that is designed for the American labor force to make us competitive. This competitiveness is important because trade negotiations with the Japanese seem fruitless. They say, oh, yes, we will consider it; oh, yes, we will think about it, and they go their own way.

Now, they are a little bit frightened because people are becoming angry, constituents are speaking out.

Finally, the Congress is beginning to make a move to do something to address these problems, and so maybe we will get more than lip service. But I don't want to count on them. I wouldn't want the American businessman to just simply rely on the Japanese good intentions because it will avail to nothing.

Statement by
William H. Draper III
President and Chairman
Export-Import Bank of the United States
Before The
Subcommittee On International Finance and Monetary Policy
Committee on Banking, Housing and Urban Affairs
United States Senate

February 7, 1986

Mr. Chairman, Members of the Committee, I am pleased to appear before you today to ask your support for proposed amendments to the Export-Import Bank Act of 1945, as amended.

We are asking you to extend the life of the Bank for five years, through FY 1991. We are asking for authority to institute an interest matching program to buy down private sector interest rates to OECD minimum rates. I would also like to speak in support of legislation to establish a $300 million mixed credit war chest.

Our first request is that you extend the life of the bank for five years, to September 30, 1991.

This will give the Bank the assurance of continuity and allow us greater flexibility in planning programs and setting policies to support the American exporter.

Since the Bank's charter was last extended, Eximbank has been making improvements in our programs at the rate of one a month. Just last month we increased our long-term financing coverage to 85% of the export value--the maximum allowed under OECD Arrangement rules. On January 15th we dropped our lending rates by 1.05%--to correspond to the new minimum levels allowed under the OECD Arrangement.

Let me talk a little bit about these OECD consensus rates, and how the international agreements we have negotiated governing these rates have affected our business.

When I came to Eximbank in 1981, we were heavily subsidizing exports by borrowing money at around 15 percent and re-lending it at 8-3/4 percent. Our competitors were lending at even lower rates. Eximbank led the way in raising export credit rates to near market levels. Our competitors followed, albeit maintaining their distance, until January 1983, when we dropped our rates to a fully competitive level. In October 1983 we agreed with our OECD counterparts to link export credit rates to market rates, and to automatically make adjustments on a periodic basis to reflect changes in market rates.

We have recently conducted a detailed analysis of the disposition of contracts on which Eximbank has offered direct credits. The facts show we are very competitive. Our analysis covers Fiscal Year 1983 through Fiscal 1985 and the total comes to $15.1 billion. Of this total, preliminary commitments for $4.6 billion were cancelled because the project or purchase was dropped or deferred for an indefinite period by the buyer.

Of the $10.5 billion in financing that has gone forward, the U.S. has won nearly half the business. That's an amazing statistic considering the high value of the dollar during this period. What is more, nearly half of those U.S. orders were financed from the private sector -- often with our financial guarantee -- but without any direct

lending from Eximbank even though we had offered OECD minimum rate financing. In FY1985, 80% of the total orders won by U.S. suppliers where we had agreed to support the sale with Eximbank credits, proceeded with private financing instead. This is the principal reason for the low utilization of our direct credit authority in FY1985.

So, in winning agreement to peg export credit rates closely to market rates, we have cut the subsidy element dramatically . . . and we have accomplished our stated purpose, which is to put the financing of exports more and more into the private sector.

Now what about the orders lost to foreign competition? Well, in every case where the U.S. exporter loses the order, we ask them why they lost. Here's what happened, based on those exporter reports. During the same three-year period, 93% of the losses were due to price or other non-financial reasons . . . generally reflecting the high value of the dollar. During FY1984 and FY1985 none of this business . . . I repeat, none, was considered by the exporter to be lost because Eximbank was not competitive with OECD-level financing. However, six percent of the total losses were due to foreign concessional aid . . . mostly mixed credits or tied aid. This remains a loophole in the consensus and we are working to close that loophole . . . a matter I will address later in my testimony.

We think these figures dramatically demonstrate our competitive strength against subsidized foreign competition. American exporters have cut costs and improved efficiency in the face of a high dollar. Now as the dollar weakens we are confident that exports will accelerate and our $148.5 billion trade deficit will begin a downward slide.

As I have indicated, lending is only one aspect of Eximbank's operations. A far larger proportion of our business is in the area of risk protection -- credit insurance and guarantees.

It is particularly in the area of risk-taking where Eximbank has led all other nations. We have supported American exporters in country after country where our competition has bowed out. During the international crisis of confidence we stayed wide open in Mexico, when such nations as Japan, Germany and France stopped doing any business at all, and are still cautious. In Brazil, the world's most heavily indebted nation, Eximbank stayed open in all its programs while Japan, Britain and Canada all closed down.

We have been able to take the leadership role in risk assumption during this period, because Eximbank takes the long-term view of the resource-rich debtor nations. We view their problems as those of illiquidity rather than insolvency. And in doing so we have kept trade lines open for U.S. exporters.

In the past 2½ years we have greatly enhanced our insurance and guarantee programs. Just last month we announced a vastly enhanced Multibuyer Policy for Exporters. We and our agent, FCIA, worked closely with a group of some 15 exporters, large and small, and representing many different industries to come up with this policy. It offers more options to exporters, such as flexibility in deductibles and the availability of uniform coverage against both political and commercial risks of non-payment on export receivables. It extends the time for reporting shipments. It reduces the requirements for reporting overdue payments. It reduces the waiting period for filing claims. In addition, to encourage use by smaller exporters with limited shipments, the new policy features a greatly reduced minimum annual premium---from $2,000 to $500. This policy features what the exporting community asked for.

Another major improvement announced this month was the extension of delegated authority to commit the Eximbank guarantee to working capital loans of up to $300,000. We took this program nationwide, after trying it out in our four-state test marketing program. This should enable us to offer pre-export help to many, many more small firms around America.

Like the extension of the working capital guarantee and the lowering of the minimum annual premium on our multibuyer policy, most of the changes we have made are aimed at increasing the use of Eximbank programs by small and medium-sized businesses. Again in FY85 we exceeded our set-aside requirements in support of small business. Congress legislated an 8% set aside for last year. However 13% of

Eximbank's total Congressional Budget Authority was devoted to small business and over 20% of the business we actually did was for small business. Eximbank has a major communication and marketing effort to reach small businessmen around the nation. And we plan to continue this effort.

This brings me to the first of two "housekeeping" changes in our legislation that we are requesting. We are asking for a clarification of the Bank's authority to charge reasonable fees for work or services performed and use these fees to offset costs and for other expenses. Mainly we intend to charge nominal user fees for such things as conferences, seminars and publications, which can be used to cover the costs of holding or producing them. This would enable us to have the users share at least part of the costs involved in our communications efforts, something that is increasingly imperative as we seek to reduce expenditures, and therefore the budget deficit.

We would also like to make a change in the language concerning the terms of directors. We want to keep the staggered four year terms, but allow any director whose term has expired to continue to serve until his or her successor has been qualified. This simply enables the Bank to keep operating smoothly in cases where appointments or reappointments are caught up in administrative or legislative delays. Without the change we are requesting the Bank could overnight find itself in a situation in which it had an insufficient number of directors to continue to take board action.

Now I would like to address another significant legislative request.

We are seeking a change in language that would enable the Bank to make increased use of private sector financing to support export loans at OECD minimum fixed-rate levels. Under our enhanced I-MATCH-II program, we would obtain private sector financing for fixed-rate export loans at competitive market rates. This money would be lent to foreign buyers at the minimum OECD consensus interest rates where necessary to meet officially supported foreign subsidized competition. When the foreign buyers repay the loans at those consensus interest rates, Eximbank would pay the lending institution any difference between the OECD rate and the competitive market rate. Neither the exporter nor the foreign buyer would be affected by this change. The transaction would appear to them the same as under the present system.

For Fiscal Year 1987 the President will propose giving Eximbank interest matching authority to support privately funded loans of up to $1.8 billion. That's an increase of around $700 million from the direct lending authority from FY86 levels. He will also be requesting a total insurance and guarantee authority of $12 billion, which is the same as our pre-Gramm-Rudman level for this year. This authorization includes up to $1.8 billion in I-MATCH guarantee authority.

The I-MATCH II program will make a substantial positive contribution to reducing the budget deficit. Under our present direct lending program we have to use our cash inflow or borrow the money we

lend in support of U.S. exports. These loans count as budget outlays just as if they were payments for salaries, rent, postage or other unrecoverable expenses.

Under our enhanced I-MATCH II program we can tap a broad section of the financial community to fund these loans themselves with our guarantee. We will put the funding for long-term loans out for competitive bidding. In the medium-term program we will make up any difference between the lenders' cost of money (based on a widely-used benchmark rate, such as the reserve adjusted, six month large deposit CD rate) plus 100 basis points and the OECD minimum fixed-rate on the note.

Under the I-MATCH II program only the subsidy element in the interest rate on these loans hits the budget.

Now, let me tell how we have improved the interest matching program since it was first proposed for FY1986.

Our enhanced I-MATCH II program draws in a much broader section of the financial community to the funding operation.

We listened to the concerns the financial institutions raised last year, and in developing I-MATCH II we are addressing those concerns. And before putting forth our present program we invited bankers--those from trade finance and from the capital market side - from small and medium-sized banks in to give us their views. The views have been valuable in helping us develop I-MATCH II. I am confident in stating we have overcome the misgivings they had about I-MATCH I.

The concerns with I-MATCH I were largely seen to be technical. We improved the assignability feature of our guarantee to make an I-MATCH loan an attractive and marketable instrument. We solved the warehousing problem--eliminating the interest rate risk between the funding of a loan and the actual disbursements. We have provided for a one time drawdown from the lender.

In our medium-term program we are not requiring banks to take a fixed rate risk over the life of the loan. We are adjusting the interest rate make-up every six months in line with market rates for six month funds.

In addition to working closely with bankers we have sought the advice of a wide range of exporters and incorporated their suggestions, too. I think we have demonstrated to their satisfaction that I-MATCH II is technically sound.

Finally I would like to ask your continued support for another piece of pending legislation: the establishment of a $300 million war chest in the Treasury Department for purposes of assisting negotiations for much greater restrictions on the use of tied-aid credits to support commercial export sales. This war chest would be able to finance over $1 billion of U.S. exports, because the funds would be blended with standard Eximbank export credits in a ratio of one part grant to three or four parts standard export credits. The President intends to request appropriations for this fund for FY1987, and we consider Congressional backing essential for our negotiating position.

As you know, the U.S. Government has been pressing our OECD counterparts to raise the level of the minimum grant element in tied-aid credits from 25% to 50%. At the President's direction we have already begun an aggressive campaign of targeted mixed credit action where we feel it will have the maximum impact on negotiations. It is directed against those countries that have been impeding those negotiations. Since adoption of our more aggressive policy last autumn, we have made eight offers of mixed credits. That is, we have offered to combine one of our normal export credits with either a low-interest long term loan from our own resources or else a grant from the war chest when that money becomes available. In some cases we surprised our competition by making mixed credit offers in the traditional markets of these countries--where they have previously not found it necessary to offer concessionary financing. Or on cases where they have outstanding mixed credit offers, we made even more concessionary offers in support of American exporters.

Two weeks ago I was in Paris at negotiations with other OECD countries. The meeting was productive by clearly pointing out that most of the 22 coutries support increased curbs on mixed credits. For example, the Japanese arrived taking the position that there should be an immediate and significant increase in the minimum grant level. Almost every other country outside the Common Market took a similar position. I hope that these encouraging signs point to a satisfactory agreement this spring, but they may not.

Until we have that agreement signed, sealed and delivered we need to keep the pressure up, which means we need favorable action on the war chest legislation.

Thank you very much. I would be pleased to answer any questions you may have.

So Exim has been a valuable tool, an arsenal in our battle to keep the trade balance from even growing larger.

If I might point out, in my own State of New York we benefited a great deal from Eximbank, and over the last 4 years New York exporters sold goods valued at approximately $5 billion. Most of those sales would not have taken place were it not for the help of Exim. That is a lot of jobs. Those are American jobs.

So I am concerned about the future, the 1987 future, the budget, and Exim's treatment because once again we see the administration coming forward with a program that last year met with some recalcitrance and reluctance by private lenders. It seems to enjoy some support this year from the private sector.

I am talking about the I-Match Program, and of course instead of private lenders what we will have is a guarantee, and I hope that that will work, and although the proposal seems to be workable, I am concerned about the potential for eliminating Eximbank because I think there are some in the Treasury who really don't care about it or who aren't looking at the long term or who aren't looking to provide those opportunities for our businessmen to be competitive, and our Government should be assisting. The other governments throughout the world are assisting their business people, and we don't do enough.

Having said that, what I am concerned about is the potential for eliminating Eximbank when the Bank's reserves and capital are depleted. That is what I am very concerned about, and it is my hope that this is not the intention of the administration.

The Export-Import Bank has been invaluable to our Nation, and I think it has to continue to play a vital role in promoting American exports when our trade deficit is approaching the $150 billion area.

We can't afford to eliminate programs that enhance this Nation's export potential. So, Mr. Chairman, I call it to your attention.

I really shouldn't call it to your attention because you have been in the forefront in this area in trying to keep the Congress mindful of this and beating back those attempts that heretofore would have rendered Exim impotent.

So let me congratulate you for your leadership and indicate what my concern is for the future.

I say this to Bill Draper. You have done an outstanding job under very difficult circumstances, and I look forward to working with you when you are in New York in your new post.

Mr. DRAPER. Thank you very much.

Senator HEINZ. Senator D'Amato, thank you very much.

Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR SASSER

We are confronting now, I think, an almost unparalleled problem in the world market. We have seen in the last 3 or 4 years our trade deficit triple. It is now at an unprecedented level in 1985 of $148 billion.

Now, if we are to compete effectively in the world markets, Eximbank has a very vital role to play.

One of the major reasons we have lost markets worldwide has been our inability to compete with other countries with regard to the financing arrangements they make for their products abroad.

We have also had the problem of an overvalued U.S. dollar in the last few years, and if we are going to be able to compete, to keep industry moving, and to produce jobs for our people, I think the Eximbank has an increasingly important role to play.

In my native State of Tennessee, we have lost over 55,000 jobs to imports in the last 5 years, and when you lose markets abroad, you have a very difficult time getting them back.

The Caterpillar Tractor Co. is being pushed out of the market, and we suffer not just in Peoria but in other places all across this country. Caterpillar will have a very difficult job in restoring its market share.

That is repeated all across the board in industry after industry after industry. Sometimes I think, Mr. Chairman, that we go into the battles of international trade with a popgun and our opponents have 150-millimeter howitzers.

So I applaud you for holding these hearings today on the Eximbank. As I said, Exim plays a very vital role in U.S. trade practices. I have joined with you and others in trying to sustain its operation over the past few years, and it has not been easy.

American industry, American workers must be allowed to compete fairly for our fair share of the international markets. The Eximbank I feel can be a critical factor in maintaining that balance.

Senator HEINZ. Senator Sasser, first, I just want to commend you for that statement and, in particular, recognize your strong support every year I have been associated with this committee for the Export-Import Bank. If it wasn't for the kind of strong support you and other Senators like Senators D'Amato, Mattingly, and Garn have given, we might not be in the relatively favorable position we are with the competitiveness mandate. The record that Bill Draper has helped to achieve these last couple of years has been a far more encouraging record than the first 2 years when he was under a lot of pressure from the Office of Management and Budget.

We have come a long way, thanks to the members of this committee, and I thank you for that.

Chairman Draper, the I-Match Program requires that the money used to finance U.S. export credits be raised by private institutions rather than through the Treasury, as we now do. Given this, it clearly raises the cost of providing such credit.

How does the administration justify this additional expense?

MORE EXPENSIVE THROUGH THE PRIVATE SECTOR

Mr. DRAPER. Mr. Chairman, I can't deny that this is true, that it is fractionally more expensive to go through the private sector than directly through the Treasury.

But in privatizing our system, I think we give the American exporters a longer view of the successful support that Eximbank can make to help them close their deals with good competitive financing.

Let me just say in this terribly tight budget period, the pressures on you, the Congress, to get 10 pounds in a 5-pound bag is just very difficult.

So what we are trying to do is give an opportunity for you to use our guarantee on private lending.

We have shown, I think, the exporters and the bankers that I-Match will work, that financing through the banking community rather than directly through the Treasury works, and we are not going off budget with everything. We are leaving any subsidy on budget. It would be bad management to take it all off budget, which you suggested, I thought.

It would not be a good idea to do that because really you, the Congress, ought to know what the costs of the Bank are—the general administrative cost and any claims that we have to pay that we can't recover and any differential between the interest rates that we charge and the costs that we have—and that ought to be clearly identified to you. But the fact that we have a flow of cash running through really shouldn't impact your decisions. But they are, because in the Appropriations Committee we got cut down from $1.8 billion to $1.1 billion this year.

The administration is requesting $1.8 billion and Congress is giving us $1.1 billion of direct credit, and next year it will be worse.

Gramm-Rudman is a serious problem to the Eximbank, and it shouldn't be because the amount of cost to the American taxpayer for Eximbank is so small in relation to the benefits—which you agree with—that it seems to me that should be clearly identified and let us go with a long-term I-Match Program that allows the private sector to benefit, the banks to get more involved. There are lots of good reasons.

So when you say it is more expensive, it may be marginally more expensive, but it is much more beneficial to the exporting community.

Senator HEINZ. Let's just be clear on something. What you have described and what you said is that we are taking the operations of Eximbank off budget because the operations are going to be conducted by banks with our guarantees.

Mr. DRAPER. No, we are only taking funding off budget.

Senator HEINZ. I didn't interrupt you, but now let me.

Mr. DRAPER. All right.

Senator HEINZ. Let me finish my sentence.

Mr. DRAPER. I just wanted to clear that up.

Senator HEINZ. I'll repeat it. What you are in effect saying or doing, through the I-Match Program, is taking the direct-credit operations of the Eximbank to private financial institutions, and saying, we want you to do exactly what we are doing; we want you to make the same kind of cash-allocation decisions; we will make the same administrative decisions; we will issue the preliminary commitments; we will decide what kind of cover; we'll decide how to meet the competitive mandate, but we are farming things out to you and, in return for this, we are going to subsidize the difference between your interest rate and what it would otherwise cost us; we will charge that against the Bank's capital, and we will enter into guarantee relationships with you, which are in and of themselves off the budget.

So what is being done, what the administration proposes to do, is to take the Eximbank off budget but have it do exactly what it's been doing.

So when you say, "Senator, your proposal to take the Eximbank off budget is deceiving," it may be that it is deceiving. But yours is just as deceiving and complicated and more costly. We are proposing exactly the same thing, only yours costs the Government more money.

COSTS OF EXIMBANK SHOULD REMAIN ON BUDGET

Mr. DRAPER. No, we're really not proposing the same thing. I'm suggesting that the costs of Eximbank remain on budget, so we need an appropriations limit for our guarantee cost.

Senator HEINZ. How do you cost a guarantee?

Mr. DRAPER. We charge for the guarantee. We charge one-half of 1 percent per year for the guarantee and, presumably, over the years, we'll break even on that. The real cost——

Senator HEINZ. What is the cost of the guarantee?

The cost of the guarantee and the Direct Lending Program of the Bank are exactly the same. The cost to the economy is in the allocation of capital through both devices. In the first instance, the present program, the capital is borrowed by the Treasury; it's lent to you and you relend it.

The guarantee allows the Bank to go to the same market the Treasury goes to. It borrows the money at a slightly different cost. We subsidize that interest difference. And frankly, it is exactly the same thing that has happened. It's a capital allocation device.

The good news is that the Treasury, the Eximbank, yourself, and all of us, agree that in order to be internationally competitive, there has to be a capital allocation device to assist exports. On that we all agree.

Where we differ is whether or not hoops should be jumped through by a complicated I-Match Program that has the appearance of taking the Eximbank off budget, when it's really duplicating the present program, although at a greater cost to the taxpayer.

Now, where have I misstated the situation?

Mr. DRAPER. I don't know. Perhaps you haven't. I never did, you know, try to say that your proposal was devious. I never said that. I am saying that we don't want to take the entire Eximbank off budget because it does have some costs and they should be appropriated by you, the Congress.

But, that aside, what we are in effect taking off budget is our direct loans, as you later said. I just took issue with the fact that you said we took our operations off budget. By taking the direct credit off the budget and making it a funding, it's just a funding as opposed to the Treasury funding in private sector; it gets banks involved. It's clear and you don't have to take into account, your Appropriations Committee, anything about the size of our authorization level.

Currently, you take that into consideration before you give us a direct credit budget, and we really got squeezed this last year, going from $1.8 down to $1.1 billion.

I suspect there will be a further squeeze next year. I would like to have a good system in place that works and we are confident it will work. It's not that complicated. It may sound complicated. It's difficult to describe, but all it is is guaranteeing a private loan and we manage the affairs between the exporter and his customer and the loans and credits and decide, as you say, on the amount of subsidy that we will allow, depending on the OECD minimum requirements.

Senator HEINZ. I'd like to interrupt and just move on to the war chest.

Mr. DRAPER. Sure.

Senator HEINZ. The administration has proposed a $300 million war chest. There's been a bill introduced here in the Senate by myself as S. 1763. We are making an effort to try to move it as quickly as possible to the Senate floor; the war chest is to be used to cover the subsidies involved in offering these credits.

If I-Match is instituted, as I understand it, funding mixed credits will require a buying down of commercial rates rather than Treasury rates at clearly increased costs.

Thus, would the implementation of I-Match cause the war chest to be depleted more quickly?

Mr. DRAPER. We think the effect will be just the same. We don't see any change.

Senator HEINZ. Well, under I-Match, the increased cost—the cost of the borrowing—let's say, in the first year, will be $10 million, the second year $20 million, the third year $30 million, and in the fourth $40 million. The costs keep going up and would be charged against the Bank's capital and reserves.

Mr. DRAPER. First of all, why do you say they keep going up?

Senator HEINZ. Because each year you have to borrow another slice. You have to finance another slice.

Mr. DRAPER. All right. The incremental cost.

Senator HEINZ. Of I-Match alone. All right. So, each year, you will get a substantial increase.

Mr. DRAPER. No, because there are payments down. There are funds coming back to the Bank as loans are paid off.

Senator HEINZ. After 7, 8, 9 years, it may level off but, by that time, you're up to, I don't know, $100 million in interest rate subsidies. Potentially, they may be more. And those are all counted as losses—costs. They are charged against the Eximbank reserves, which have shrunk, as you know. We are concerned about those reserves and Bank capital, which has totaled over $1 billion.

And that is why I say that the war chest will be depleted more quickly.

Mr. DRAPER. No, the war chest would be $300 million that you would give to the Treasury as grant money, and that grant money would be seeded in with our normal loans or I-Match loans.

Senator HEINZ. Where does that money come from?

Mr. DRAPER. It comes from your appropriation to the Treasury, $300 million of grant. That would go to the Treasury and it would be $300 million, whether I-Match Program or Direct Credit Program.

Senator HEINZ. Doesn't it come out of Exims capital and reserves?

Mr. DRAPER. No. It will come from the Treasury appropriations.

Senator HEINZ. Well, my time has expired. I want to recognize Senator Proxmire for any opening remarks he cares to make and also questions.

By the way, I want to apologize to Senator Proxmire. He asked me to start the hearing at 10 a.m. because he had a conflict with the Joint Economic Committee. I wanted to accommodate him but, unfortunately, we just had so many witnesses that I felt we had to start at 9:30. Senator Proxmire is one of the most punctual people in the entire Senate. We all know what his voting record is and he makes the rest of us look bad. Bill, I apologize, but due to the number of witnesses, including one from the GAO who was a late starter but who you wanted and who I'm pleased to have, we have made you late apparently. But I want everyone to know your heart was pure. You were going to be here on time if it hadn't been for a committee conflict.

Senator PROXMIRE. John, thank you very much. That's as fine a compliment that I've ever received from a Republican. I can tell I'm not running.

Senator HEINZ. Whether or not you got compliments from a Republican, it wouldn't make any difference the way people in Wisconsin keep returning you without any opposition.

Senator PROXMIRE. Well, in 1988, you will be widely quoted throughout the State.

Senator HEINZ. If I have to be quoted in helping a particular Member on the other side, I can't think of a better one to be quoted on behalf of.

Senator PROXMIRE. John, you must want to get something. [Laughter.]

OPENING REMARKS OF SENATOR PROXMIRE

Senator PROXMIRE. Mr. Draper, I won't take time now to deliver the full opening statement I prepared. Instead I'll ask you to include that, Mr. Chairman, in the record of this hearing and will just make a few points right now.

One of the main issues before us today is whether we should replace Eximbank's Direct Loan Program with an Interest Rate Subsidy Program known as I-Match. While I recognize this proposal is essentially a bookkeeping gimmick, I think it has some merit. It must, however, be coupled with other points before I can support it.

A key problem with I-Match is that the Bank plans to fund it by continuing to run down its already depleted loan loss reserves and capital. Now at my request the committee is going to hear from the General Accounting Office a little later and GAO in its latest report on the Bank suggests that its loan loss reserves may already be depleted. If the GAO is right, the Bank will soon be broke.

Yesterday I introduced legislation that could remedy this matter. My bill is not complicated. It simply requires the Bank to maintain a minimum level of capital stock and retained earnings in an amount not less than $2 billion and authorizes Congress to appropriate the funds the Bank will need to comply with that requirement.

This means it will pay for the Bank's losses as they are incurred and not wait until it's broke.

One other matter, on Wednesday of this week, I also introduced a bill to stop the Export-Import Bank from making loans to the Marxist Government of Angola. I cannot for the life of me understand why this administration wants the Eximbank to use its scarce resources to provide funds to that Marxist Government which it is now trying to overthrow by providing covert military support to its chief opponent, another Marxist. It seems we're aiding all the Marxists by following a policy that must have been designed by the Marx Brothers—Groucho and Harpo.

In my view, we should aid neither side in that Angolan war. I would be very interested in hearing what our remaining witnesses have to say about both my latest legislative proposals.

Finally, I take note this is ave atque vale for our distinguished Director, Mr. Draper. He will soon be leaving the Eximbank. Although we've had some policy differences during his tenure at the Bank, I hold him in the greatest respect. He has run the Bank very well under very difficult circumstances. He's a man of absolute integrity. He never loses his good humor even in trying circumstances. I wish him well in the new duties he will undertake at the United Nations.

[Complete prepared statement of Senator Proxmire follows:]

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Mr. Chairman, I want to commend you for continuously getting this subcommittee off to a timely start. Last year we had an oversight hearing on the Export-Import Bank and its then proposed new I-Match Program just 1 day after the President submitted his 1986 budget. This year we are starting our review of the Bank's operation only 2 days after the President submitted his 1987 budget. And once again one of the main issues before us is whether to replace the Eximbank's Direct Loan Program with an Interest Rate Subsidy Payment Program, known as I-Match. This proposal is a result of the administration's attempt to reduce budget outlays. Under it the Bank would obtain private sector financing for fixed-rate export loans at competitive market rates. This money would be lent to foreign buyers at below market rates where necessary to meet officially supported foreign subsidized competition. When the foreign buyers repay the loans at those below market rates, Eximbank would pay the commercial bank lender any difference between the subsidized rate and the competitive market rate. If the Bank stops making direct loans and instead makes these subsidy payments to banks it would disburse less money. That would count as reduced Federal spending and the budget deficit would be smaller. For example under the Bank's current Direct Loan Program if the Bank made $1.8 billion in direct loans—that total amount would count as a budget outlay. Under the new program only the amount of the interest subsidy, perhaps $150 million to support a $1.8 billion Direct Loan Program, would show up as a budget cost. While I recognize this is essentially a bookkeeping gimmick I think the proposal has some merit because it makes explicit the amount of money the Bank will spend each

year to subsidize exports. It must, however, be coupled with other charter reforms before I can support it.

One key problem with the proposed new program is that the Bank intends to fund its new program, not from appropriated funds, but rather by continuing to run down its loan loss reserves and capital. This is of concern to me because the Bank is fast going broke and could soon be without any capital to cover possible losses. Two years ago I sponsored a bill that would have put the Bank on a pay as you go basis with appropriated funds. I asked Bank authorities to comment on my proposal. Mr. Draper, the Chairman of the Export-Import Bank who is with us today, wrote to me and said he shared my concerns about the decline in the level of the Bank's equity position. He said, however, he did not think that would hurt the Bank's credibility because "all obligations of the Bank are obligations for which the full faith and credit of the U.S. Government is pledged." In other words don't worry if the Bank is losing lots of money and is fast going broke—the American taxpayer will be around to pick up whatever tab is ultimately run up. The Congressional Budget Office, in contrast to the Bank, was more concerned about the exposure of our taxpayers. It said my bill——

> * * * would improve budgetary oversight and control of the Eximbank. By requiring an annual appropriation for operating losses, the bill would force the Congress to recognize annually the subsidy inherent in Bank lending.

I am pleased the GAO, which annually examines, the Eximbank's financial statements, has a representative here to testify today. As long ago as 1975 the GAO began expressing concerns about the adequacy of the Bank's capital reserve in light of its declining income. In 1981 the GAO warned that the Bank's reserves were not adequate to cover possible losses on loans and guarantees that had not yet matured. In its most recent report on the Eximbank, dated May 29, 1985, the GAO said that an audit of the Bank's financial statements, using generally accepted accounting principles, suggests that the Bank's reserve for contingencies and defaults may already be depleted. If GAO is right it means the Bank is now consuming its original $1 billion in capital to fund its ongoing operations. When that money is gone the Bank will be broke. Last year the President's budget projected the Bank would have losses from 1986 through 1990 that would reach $2 billion. Such a situation impairs the credibility of the Bank as a viable institution and sets up a situation that could require a massive bailout by the Congress. The Bank will soon be without any capital to cover possible losses. This means the Bank's bad loans will be the taxpayer's responsibility. If we ignore this problem the potential liability of the American taxpayer for the Bank's operations will continue to swell as Bank commitments expand. Allowing the capital position of the Eximbank to deteriorate while its obligatibns increase contrasts sharply with the policies Congress is following with regard to commercial banks to ensure their safety and soundness. In 1983 Congress directed Federal banking agencies to require banks to maintain adequate capital levels and to set up special reserves for certain types of international loans, among them those loans for which there were no definite prospects for the orderly restoration of debt service. Since then, the FDIC, Comptroller, and

Federal Reserve have taken action to require the banks they regulate to increase the ratio of their capital and reserves in relation to bank exposures. The Eximbank, as the GAO continues to point out, has not taken similar precautions.

We should act now to correct this anomalous situation. The Bank's charter expires on September 30 of this year and the administration has requested it be renewed through September 30, 1991. At its current rate of losses the Bank will be broke long before then unless Congress acts to provide it with funds.

Yesterday I introduced legislation that could remedy this matter. My bill is not complicated. It simply requires the Bank to maintain a minimum level of capital stock and retained earnings in an amount not less than $2 billion and authorizes Congress to appropriate the funds the Bank will need to comply with that requirement. It also obligates the Bank to estimate its loan losses and deduct that amount from its retained earnings in accordance with generally accepted accounting principles. I think we should adopt these Bank reforms at the same time we institute the new I-Match Program.

One other matter—before I close. On Wednesday of this week I also introduced a bill to stop the Export-Import Bank from making loans to the Marxist Government of Angola. I cannot for the life of me understand why this administration wants the Eximbank to use its scarce resources to provide funds to the same government it is now trying to overthrow by providing covert military support to its chief opponent—another Marxist, Jonas Savimbi. In my view we should aid neither. I will be very interested in hearing what our witnesses have to say about both my legislative proposals.

Thank you Mr. Chairman.

THE 2-YEAR SUNSET PROVISION

Now, Mr. Draper, during the Banking Committee's October 30 hearing on the administration's mixed-credit war chest proposal, Assistant Secretary Mulford of the Treasury Department, told us that the 2-year sunset provision in the administration bill was designed "to avoid an open-ended entitlement program."

When Senator Heinz asked about the wisdom of such a provision Mr. Mulford said:

> We do not want to create something that gets out of hand and becomes an entitlement program. I think it is very helpful to have a sunset provision which forces a review which would either retire the program because it has been successful or might take some different course depending on what the situation is at the time.

Is that still the administration's position? And if not, why isn't it?

Mr. DRAPER. Yes; I don't think the administration's position has really changed in that regard.

Senator PROXMIRE. They still want a 2-year sunset?

Mr. DRAPER. Right.

Senator PROXMIRE. Mr. Draper, the administration's original mixed-credit war chest proposal contained language stating:

> Notwithstanding any other provision of law, upon a declaration by the President that any portion of such funds is not required to achieve the purpose of this section, the funds so determined to be in excess of requirements shall cease to be available.

Secretary Mulford testified in favor of the provision saying that:

The war chest should be dismantled when sufficient negotiating progress has been achieved. The President should have the discretion to make that judgment.

Now that makes good sense to me. Is that still the administration's position?

Mr. DRAPER. Yes, it is.

Senator PROXMIRE. In the I-Match Program which you submitted to Congress in 1985—that was I-Match I—the administration proposed to deauthorize the Bank's Direct Credit Program at the same time the new Interest Matching Program was authorized.

I note that this year the administration is not asking Congress to deauthorize the Direct Loan Program. Does the administration want to administer both loan programs as many of the exporters who will testify later are proposing; and, if not, why shouldn't Congress deauthorize the old program at the same time it establishes the new one?

Mr. DRAPER. We aren't asking for a funding request but we feel that there's no point in deauthorizing it at this point.

Senator PROXMIRE. You're not asking for it. Would you have any objections if Congress proceeded to deauthorize it? Would the administration be opposed to that?

Mr. DRAPER. I don't know that we have really considered it. I don't think it's necessary, as I said in the House the other day. I really think the I-Match Program works perfectly well and the Direct Credit Program will not be needed, and so I would not personally be very concerned about it.

Senator PROXMIRE. In that case I would think there would be no real objection.

Senator HEINZ. I object.

Senator PROXMIRE. You're close to being the administration, John, but you've just got to be elected President to do it. That may happen. [Laughter.]

On page 4 of your testimony, Mr. Draper, you note that in the area of risk taking the Eximbank has led all other nations. You point with pride to the fact that the Bank has supported American exporters in country after country where your competition has bowed out. You cite Brazil and Mexico as two examples.

In view of the Bank's shrinking loan loss reserves, do you think that's a wise policy? If large amounts of these risky loans and loan guarantees go bad, who will pay for them if the Bank's loan loss reserves are exhausted?

Mr. DRAPER. Well, we always as a Board—and there are five of us on it—actually there are four of us now since there's one vacancy—we as a Board always have to come to grips with the question of is there reasonable assurance of repayment in the long run, and we never have made a loan commitment or a guarantee where we have not felt that in the long run there is that reasonable assurance of repayment.

So I don't think it's a wise thing to use our resources if there were a likelihood that we wouldn't be repaid, but most of these problems are work-out situations. They're illiquid but they're not insolvent. As serious as the problems are in Mexico, for example, and with the declining oil prices, they're going to get worse, we

still expect to get repaid on all the loans that we're involved with down there that have the guarantee of the Government.

Now there were some private loans that were made before I was there and after I was there that some of which we guessed wrong on, and that will happen. Once in a while we make a mistake. We thought there was reasonable assurance at the time we made the loan. But we expect to recoup 80 percent of those claims that we have down in Mexico.

ANGOLAN AID

Senator PROXMIRE. I have one final question. Is there any intention to make a loan to Angola and would you be in a position to do so now under present circumstances? As I recall, when I asked you why you made the last loan to the Marxist Angolan Government, which is supported by the Soviet Union, you said you had no choice because Angola was not listed by the State Department as a Communist country and the loan was sound and therefore you went ahead.

Mr. DRAPER. That's correct.

Senator PROXMIRE. I want to know if that's still the situation and if you're in a position to make a loan now and if you think the Bank should do so? Obviously, you're not going to be there, but do you think the Bank should do so?

Mr. DRAPER. Well, I think we would study it long and hard right now if one came up. By the same token, we by law are restricted from not doing business where we do have the reasonable assurance of repayment. We can't just deny for political reasons, I should say.

Senator PROXMIRE. But that wasn't the case before. When you were here before and I asked you about the loan to Angola you said that you had no choice, that you were in a position where you had to make that loan, like it or not.

Mr. DRAPER. That's correct.

Senator PROXMIRE. Is that still the case?

Mr. DRAPER. Yes, it is. Under the law, we have no choice but to make it, but I'm saying that we'd sure study it a long time until the problem is resolved more from the policy standpoint because the Secretary of State can always tell us that he has decided that it is not in the U.S. Government's interest to make the loan, in which case we wouldn't make it.

Senator PROXMIRE. If he doesn't make that statement or if the President of the United States doesn't make that statement, you have to go ahead and make the loan?

Mr. DRAPER. That's correct. And we haven't really done any direct loans there for 18 months.

Senator PROXMIRE. Well, I've introduced legislation to forbid the Bank from making any loans to Angola until Cuban and Soviet military personnel leave that country. That would correct the situation.

Mr. DRAPER. Right.

Senator PROXMIRE. Thank you.

Thank you, Mr. Chairman.

Senator HEINZ. Senator Proxmire, thank you.

I have a couple more questions for you, Bill.

While Exim's recent loan activity has been at historically low levels, partially as a result of factors beyond your control, isn't part of the decline due to a less than aggressive competitive posture on Exim's part? We continue to hear complaints from the exporting community about problems with Exim's medium- and long-term programs.

Now I do realize that you've made significant efforts to improve the Bank's competitiveness in recent years, so I'm not being necessarily critical of you, but what additional significant changes do you think can still be made to improve the Bank's competitiveness given your existing programs?

FOREIGN CONTENT REQUIREMENT

Mr. DRAPER. Well, I think there's only one area that we are still studying and that's in the foreign content requirement that we have. Currently, on direct credits, long-term credits, we restrict to zero percent foreign content in any shipment that goes out, and 10-percent foreign content for medium-term which are smaller typically, and up to 50-percent foreign content for short-term shipments.

Now that could be perhaps made less restrictive. The problem is, of course, that it's very hard in a short-term shipment to know just how much foreign content is in there because some companies will take products from abroad and put them into their products and ship them out as an export and we don't really try and figure out how much foreign content is in there. In short term we just can't do it. We have insurance policies that cover shipments that we don't really see. So in the larger, longer term ones it's easier to tell that there is foreign content and we don't allow it.

But we're studying that one. I think in other areas we are——

Senator HEINZ. I gather there are some devices you can use where there is a foreign content problem and you want to be sure that you're only financing U.S. content. You could, for example, set up some kind of a clearinghouse and make some reciprocal arrangements with other export credit agencies that could mitigate that problem.

Mr. DRAPER. Yes, except in the short term it's a fast turnover and we are insuring the exporter and assuming that over half of——

Senator HEINZ. But you don't need any change in your charter to address this problem?

Mr. DRAPER. No; we're not looking for a change in the charter. In fact, we think the policy we've got is right, but I just mention that that's one that we are studying. In fact, we are having a meeting next week on it.

Senator HEINZ. One of the specifics that has been brought to our attention is the 2-percent credit fee. Now the reason that's apparently a problem is that, although there are similar fees imposed by other countries, they are usually amortized over the life of the loan and/or they are risk related.

Why can't we do the same thing as our competitors?

Mr. DRAPER. Well, we could, but the fees would go up for the ultimate customer, the exporter, because our 2-percent fee is called an application fee but we have no insurance fee at all. We self insure where France, Germany, England all go through an insurance system and there are insurance fees that are laid on that are a lot higher than that 2 percent if amortized, or up front, it doesn't matter. Our 2-percent fee is below it. It's about 2 percent related to an average of about 3 for those insurance fees. So it's just a different kind of a tap.

Senator HEINZ. But my point is that other countries spread those fees out over the life of the loan.

Mr. DRAPER. Well, we spread out our 2-percent fee. If they want to pay for it over a 3-year period, they can. And of course, in the medium-term loan, that's the average of the loan because there's a paydown, of course, as you know. So I really don't think that's uncompetitive. Nobody has lost anything.

Senator HEINZ. We'll hear from our witnesses as to why they think there's a problem, if they do.

Let me ask you one other question. At the present time, regarding medium-term commitments, only U.S. banks, not exporters, can obtain medium-term commitments; is that right? We don't let the exporters apply?

Mr. DRAPER. I see. Yes, it is true that we only have the Medium-Term Guarantee Program for banks and not nonbanks.

Senator HEINZ. Could you explain why Exim doesn't allow U.S. exporters instead of those banks to apply for medium-term PC's, as in fact exporters can do under the long-term program?

Mr. DRAPER. I know, because you raised that question with me privately and we are looking into that. I don't know if we could perhaps do nonbank guarantees. As of now we have had banks only that come in and get warranted by our certification system and I don't know. It's something we are looking into, though.

Senator HEINZ. So you are going to rethink the eligibility requirements in view of the fact that both non-U.S. banks and nonbank lenders are pretty active in this area?

Mr. DRAPER. We haven't had much demand from exporters for export financing from nonbanks, so it's very possible we could change the policy on that.

Senator HEINZ. Well, Chairman Draper, I may have a few additional questions to submit to you in writing at the conclusion. As always, it's good to have you before the committee. I simply want to add my words of commendation to those of Bill Proxmire. We wish you well. And as Senator D'Amato said, please register Republican when you move to New York.

Mr. DRAPER. Thank you very much, Mr. Chairman. I've enjoyed being in front of this committee every time and the support you've given me and the Eximbank has not gone unnoticed. We really respect you for it and keep up the good work.

Senator HEINZ. Bill, thank you.

Our next panel of witnesses represent five organizations. Ladies and gentlemen, will you please come forward?

Our first witness will be Rosemary Mazon, who is here representing the Coalition for Employment through Exports. Rosemary, it's nice to see you back and I would ask you to please proceed. To the

extent that any of you are submitting really lengthy statements, I want to assure you all, that your entire statements will be made a part of the record. If you care to summarize, and we always so encourage, we would be most appreciative.

STATEMENT OF ROSEMARY MAZON, DIRECTOR, INTERNATIONAL AFFAIRS, THE ALLIED SIGNAL COMPANIES, ON BEHALF OF THE COALITION FOR EMPLOYMENT THROUGH EXPORTS

Ms. MAZON. Thank you, Mr. Chairman and Senator Proxmire. CEE's statement is quite lengthy. It's weekend reading and I would ask that it be submitted for the record.

My name is Rosemary Mazon and I am director of international affairs for Allied Signal Inc. I served for 6 years as an officer of the Export-Import Bank of the United States and more recently as chairman of the Bank's advisory committee.

I appreciate this privilege to offer, along with my colleagues at this table, some recommendations and observations relative to the function and operation of Eximbank.

I am representing today the Coalition for Employment Through Exports known to most of you as CEE. The group is made up of 52 export-oriented companies which derive a significant portion of earnings from the overseas sales of U.S. goods and services, 14 labor unions whose members are heavily dependent on export sales for their jobs, and 12 Governors from States that recognize the importance of exports to a healthy American economy. A list of the members of CEE has been submitted for the interest of this committee.

We are grateful for these timely hearings on the reauthorization of the Eximbank. With the U.S. trade deficit this year nearing $150 billion and because U.S. exporters continue to be disadvantaged by the outright subsidies other countries provide for their exporting businesses, it is crucial that we fight to assure a competitive aggressive and viable Eximbank.

EXIM IS A CRITICAL COMPONENT OF U.S. EXPORT SALES

I don't think I have to emphasize how important Eximbank is in today's international competition. The financing programs available through the Bank are an increasingly critical component in U.S. export sales. American corporations no longer have a monopoly on technology and industrial efficiency. It is doleful to witness the decline in the U.S. share of export market in many key industries worldwide over the last several decades. Our major foreign competitors continue to be heavily subsidized by their governments and international discipline to eliminate government-aided export financing allowing a market dependent on quality and price remains to be achieved.

During the 1983 rechartering process, this committee gave invaluable support and assistance in adjusting the Bank's charter with significant improvements as a result. In particular, Congress directed the Bank to be more competitive in the support of U.S. exports.

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Unfortunately, the total authority exercised by the Bank in the direct credit area over the past 2 years is proof positive that Eximbank is not meeting that challenge to the best of its ability.

CEE does not want to bring too full a platter to this table because the agenda for this session fairly boggles the mind, but we do have some specific goals relative to Eximbank's rechartering.

One, to have Congress reauthorize the charter for a reasonable length of time. By reasonable, we suggest 6 years.

Two, strengthen the Bank's mandate both through charter amendment and adding implementation directions to the report language.

Three, to address in positive fashion the severe budgetary squeeze which the overall budget deficit and fiscal situation imposes on the Bank.

You may ask why 6 years? We feel this will show some certainty relative to the Bank's permanence both to the exporting community and also to the overseas purchasers of U.S. goods and services.

On the competitive issue and for a number of reasons, Eximbank has not met the directive of the Congress to be fully competitive with Government-supported rates and terms and other conditions provided in support of export sales by principal countries whose businesses compete with ours in major world markets.

For certain purposes, the Bank instituted a series of administrative steps which have hampered its ability to respond as strongly as we had hoped for following the last rechartering process.

Some examples: The Bank imposed a 2-percent upfront fee on borrowers making purchases of U.S. goods and services less attractive costwise. Direct credits were reduced from 85 to 65 percent of the U.S. export value. This policy was reversed only recently back to the 85 percent cover, but only after a period of some costly financing charges for the U.S. exporter.

The Matching Credit Program has been allowed to atrophy. Although Eximbank has had the capability to provide mixed credits, none were offered until the Treasury Department instructed the Bank to venture into the mixed-credit area in late 1985. Much business was lost to U.S. companies before this delayed reaction to mixed-credit opportunities and thus many jobs in the U.S. suffered accordingly.

The Medium-Term Program continues to have significant implementation problems ranging from lack of consistency in transaction size to risk sharing.

Finally, and I repeat myself, Eximbank has not fully utilized the authority approved by Congress for the Direct Credit Program.

I believe the figures will show that exercise of the direct credit authority is at its lowest ebb in perhaps 12 years.

STILL PLAYING CATCHUP

On the issue of mixed credits, they have been a topic of conversation in recent months in this city and they have been in vogue in many of our major competitor countries for some years. We are now beginning to play catchup due to the President's decision to focus on the mixed-credit practices across the world marketplace beginning in late 1985 with his encouraging trade message. The

mixed-credit legislation proposed by a number of your wise colleagues and by yourself, Mr. Chairman, are on the front burner happily, and hopefully we will see the establishment of the proposed war chest of $300 million in the not too distant future.

However, the gravity of the mixed-credit dilemma remains with us. To adequately address and combat the subsidized financing offers made by other governments in support of their export sales, the Tied-Aid-Credit Program incorporated in the Trade and Development Act of 1983 should be modified to fortify its implementation.

In reference to the Medium-Term Program and the improvements needed in that area, my colleague from Caterpillar is more conversant with the Medium-Term Program and I would defer to his statement for comments on that service.

But CEE's testimony for the record incorporates several recommendations on this program in detail suggesting that there is much room for review by the Bank on the Medium-Term Program provisions.

I have had experience with Eximbank's charter provisions both as an employee and subsequently with U.S. companies that have made use of its Direct Credit Program over many years. Congress created a workable Direct Credit Program early in the Bank's formation. That same successful program should remain in place even if the new and experimental I-Match II Program becomes operative. There are many factors that may make the plan workable just as there are many that can contribute to its unworkability. If it meets its purpose, fine. If it does not, we must have the direct credit facility to fall back on to support U.S. export sales.

The arguments you will hear this morning to retain the Direct Credit Program while I-Match II is put into operation as a complement may seem repetitious, but with good reason. Working in tandem, the Direct Credit Program and I-Match II may well save many U.S. export sales that could otherwise be lost to American industries for lack of competitive financing. Before leaving I-Match II, the Coalition for Employment Through Exports has reviewed the revised Medium-Term I-Match Program and notes with appreciation to Eximbank that many of the problems in the initial draft of this new program have been resolved in the final proposal.

In the spirit of continuing cooperation and if remaining areas of concern are clarified by Eximbank, CEE is prepared to support the revised version based on the workability of the program but not on the budgetary element.

One must caution that one key element of whether or not I-Match can be utilized effectively is private bank participation. Unfortunately, we sense a lack of total commitment on the part of private banks particularly because of tax implications.

The way in which the I-Match II Program is presently constituted and due to the fact that its costs will be funded from Exim's reserves, it will actually take the Bank off budget. This treatment reflects the way in which Exim should be scored, that is, no outlays in the Federal budget and therefore no pressure on the deficit. This budgeting treatment makes I-Match II an attractive additional tool to the Bank's financing arsenal.

CEE continues to have grave concerns that Eximbank remains a part of the unified budget rather than to be moved off budget to a credit budget, but given the difficult budget environment in which Congress must act this year, CEE limits its recommendations for action to one area and that is carryover authority.

Perhaps Congress should consider a no year appropriation for Eximbank on which unused budget authority can be carried forward to succeeding years without being scored again, or at least that such authority be carried over for the next succeeding fiscal year. This would not impose an additional cost in the budget since full budget authority would also be scored in the initial year of the appropriation.

Importantly, it would also temper the annual Federal budget battles which are so time-consuming and debilitating.

CEE's members thank all of you for your willingness to consider our ideas for constructive changes to Eximbank's charter and thus to its continuing operations.

In closing, CEE agrees with Chairman Heinz' opening statement calling for a real understanding of the budgetary treatment of Eximbank. Thank you.

[The complete prepared statement follows:]

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STATEMENT

BY

ROSEMARY MAZON

INTERNATIONAL AFFAIRS DIRECTOR

ALLIED SIGNAL INCORPORATED

on behalf of

THE COALITION FOR EMPLOYMENT THROUGH EXPORTS

before the

SUBCOMMITTEE ON INTERNATIONAL FINANCE & MONETARY POLICY

of the

SENATE BANKING COMMITTEE

February 7, 1986

Coalition for
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Good morning Senators. My name is Rosemary Mazon. I am Director of International Affairs for Allied Signal Incorporated and a long time student of Eximbank -- for 6 years an officer of the Bank, and most recently as Chairman of Exim's Advisory Council.

I appreciate this privilege to offer, along with my colleagues at the table, some recommendations and suggestions relative to the function and operation of Eximbank. I am representing today the Coalition for Employment through Exports known as CEE, made up of 52 export-oriented companies which derive a significant portion of earnings through the export of U.S. produced goods and services, 14 labor unions whose members are heavily dependent on export sales for their jobs, and 12 governors who recognize the importance of exports to a healthy American economy. A list of our membership has been submitted for the record.

We appreciate your Committee's early and timely hearings on the reauthorization of Eximbank. The U.S. trade deficit this year is nearing $150 billion and U.S. exporters continue to be disadvantaged by foreign export financing practices. It is crucial for us to seek a competitive, aggressive and viable Eximbank.

We approach these hearings recognizing that:

1. Eximbank is an essential and needed factor in today's international competition.

2. Export financing is an increasingly critical component in the marketplace.

3. American corporations no longer have a monopoly on technology and industrial efficiency.

4. The U.S. share of the world market in many key industries has declined markedly over the last several decades.

5. Our major foreign competitors in world markets are heavily subsidized by their governments.

6. International discipline to eliminate government-aided export financing, allowing a market dependent soley on quality and price, remains elusive.

Again, CEE appreciates this Committee's invaluable support and assistance during the 1983 rechartering process when significant improvements were made to the Bank's charter. In particular, Congress directed the Bank to be more competitive in supporting U.S. exports. Unfortunately, one of our missions today is to state that despite your leadership in directing the Bank to be fully competitive, Eximbank's response to that challenge has been minimal. The Bank's use of its authority for the past fiscal year is proof of that disappointment.

CEE's main goals in the rechartering effort are:

1. To reauthorize the charter for a reasonable length of time. We feel a six year reauthorization is an appropriate time period to insure a stable footing for our sole export financing institution.

2. To further strengthen the Charter's competitive mandate both through Charter amendment and implementation directions contained in report language, and ..

3. To address in a positive fashion the severe budgetary squeeze which the overall budget deficit and fiscal situation impose on the Bank.

RECOMMENDATIONS:

Length of Reauthorization

1. As indicated, CEE recommends a 6 year extension to the Charter. The Senate had supported a six year extension in 1983. This will show some certainty relative to the Bank's permanence both to the U.S. export community and to their overseas purchasers. (Section 8 of Charter; "Until September 19, 1992").

COMPETITIVENESS ISSUE

As stated earlier, the Bank has been directed during the 1983 recharter effort to be "fully" (emphasis added) competitive with the government supported rates and terms and other conditions available in the financing of exports of goods and services from the principal countries whose exporters compete with United States exporters". (Sec. 2(b)(1)(a)) We believe the Bank has not been as competitive as Congress intended nor as aggressive as the export community feels is necessary to help reduce the trade deficit, expand exports and keep American products competitive in world markets.

Instead, the Bank instituted a series of administrative steps which made the Bank less competitive than it had been.

1. A two percent up front fee was imposed on borrowers.

2. Eximbank Direct Credits were reduced from 85% to 65% of the U.S. export value. This policy was only changed back to the 85% cover on January 7, 1985 -- a convenient time frame for these hearings.

3. Few Mixed Credits offers have been made until the last four months and the Matching Credit Program has atrophied.

4. The Medium Term Program has significant implementation problems ranging from lack of consistency in transaction size to risk sharing.

5. And finally, Eximbank has not used the resources provided by Congress for the Direct Credit Program.

CEE recommends the following actions to further insure the competitive mandate of the Bank:

First, as a Charter Amendment, delete the second sentence of Section 2(b)(1)(B) and substitute language which directs the Bank to provide financing which shall be:

"Fully equivalent in essential terms and conditions to the export financing available from other countries and their government-related or supported agencies and instrumentalities through which foreign exporters compete with United States exporters."

This addition gives Congress's "fully competitive" mandate a clearer meaning by requiring an Eximbank financing package to be fully equivalent in terms and conditions to match those of foreign competitors.

Second, as a Charter Ammendment, to require as part of the Bank's Annual Report to Congress, the rationale for each rejection of an American exporter's request for funding where there has been at least one export financing proposal offered from another OECD country -- this will assist Congress in evaluating whether the Bank is meeting its competitive mandate.

Mixed Credits/Tied Aid

The Mixed Credits predatory practices by foreign governments remains a severe problem. Current legislative proposals in Congress do not address the full range

of concerns of the export community to adequately combat these practices. The Tied Aid Credit Program incorporated in the Trade and Development Act of 1983 has been ineffectively implemented and should be modified to improve its operation. CEE recommends amending sections 645(d), 646(a)(2), and 644(a)(1)(b).

We recommend amending section 645(d), which now restricts AID to those "Economic Support Funds allocated for Commodity Import Programs" in financing "a tied aid credit activity." This provision restricts AID resources to a small allocation and discourages utilization of the tied aid program. Instead, AID should be able to use, at its discretion, all non-earmarked Economic Support Funds. This can be accomplished by stating that "the Administrator of AID may use funds made available to carry out Chapter 4 of part II of the Foreign Assistance Act of 1961 (relating to the Economic Support Fund) to finance tied aid credit activities pursuant to this section."

In section 646(a)(2), CEE recommends a "unaminous" consent of NAC requirement to be changed to require a majority vote of the Council. A majority vote procedure is more than sufficient and negates the ability of a recalcitrant agency to block fund use.

Finally, Section 644(a)(1)(b) should be amended to allow for both offensive and defensive use of the Bank's Tied Aid Credit Program. The Tied Aid Credit Program should be used as a negotiating tool to reduce government subsidized export financing. Its strategic use in financing exports to foreign markets which are potential markets for countries which engage in tied aid conventional financing and in matching these practices assists in that purpose.

Matching Credit Program Section 1912

In 1978 and again in 1983, Congress addressed the concern of U.S. exporters to allow Eximbank to provide financing within the United States if foreign sales to the U.S. are being offered involving foreign official export credits "which exceed limits under existing standstills, minutes or practices to which the U.S. and other major export countries have agreed."

The Congress could not have been clearer in directing the Secretary of the Treasury and Eximbank to make this Section 1912 an effective instrument to prevent foreign countries from selling their products in the U.S. using export financing which violates OECD limits.

It is evident that the discretionary nature of Section 1912 was a mistake. Recent interpretation of this section appears to indicate that it cannot be invoked unless an actual signatory to a credit agreement with the U.S. violates its terms. Clearly this is an incorrect interpretation and extends an uncompetitive element into our domestic marketplace.

Section 1912(a)(1) should be amended to make it clear that a matching credit is available when any country violates OECD or other agreements to which the U.S. is a party whether or not that country is a signatory itself. We wish to note that this program should be operated in such a manner so as not to negate the Bank's primary purpose of supporting exports.

As a close to our recommendations relative to the Bank's competitiveness, we recommend definitive report language as to the intent of Congress in the following:

1. Clarify the "reasonable assurance" standard in Section 2(b)(1)(B) so the Bank's policies are not overly restrictive. A standard where one or more OECD countries have offered official export credits to the same potential customer should be a significant factor in the Bank's decision to support a U.S. offer.

2. The two per cent up front fee which the borrower is required to pay symbolizes the non-competitive posture of the Bank. Other OECD credit agencies do not impose such an up-front fee and the Charter does not mandate one. CEE recommends Congress direct the Bank to spread any such fee over the term of the loan.

3. As stated earlier, the Bank has recently begun an 85% coverage policy. We recommend Congress take favorable note of this action and that this coverage remain available whenever necessary to maintain the Bank's competitiveness in this area.

4. Unlike many othe OECD export financing agencies, Eximbank has not funded host country costs. CEE requests Congress to direct the Bank to make host-country funding available, on a case-by-case basis, where necessary to secure a U.S. sale.

5. We recommend that Congress in report language direct the Bank to review its policies with respect to the financing of foreign content in American export products in the long term program. CEE feels that permitting modest foreign content funding would not encourage outsourcing amd make us more competitive with other foreign export credit facilities which do provide foreign content coverage for their exports.

   CEE and its member labor organizations would be available to assist Exim in exploring procedures and criteria where, on a case-by-case basis, and where necessary to secure a U.S. sale, a percentage foreign content element (as the Bank now exercises in the medium term program) would be considered.

6. The Medium Term Credit Program was enacted in 1983. Its operation has been disappointing to exporters seeking to use Exim's assistance. My colleage from Caterpillar Tractor Company is much more fluent in the issues surrounding the Medium Term Program and I defer to his statement and comments in the interest of brevity.

Senators, I have just completed a rundown of the areas we feel need improvement relative to Eximbank competitiveness. These are issues which need addressing whether or not a Direct Credit or the proposed I-Match II Program exists.

I-MATCH II

Exporters, most business and export organizations, and CEE members strongly opposed the Administration's 1985 I-Match proposal on three basic grounds. First, the way in which the I-Match proposal was structured made it unattractive for the private commercial banks -- whose involvement was essential to the operation of the program -- to participate at all. Private lenders were unwilling and unable to assume the risks inherent in the 1985 program. Second, I-Match was a somewhat more expensive program than direct credits for an equivalent amount of loans because the cost of private bank borrowing would be higher than the cost of Treasury borrowing directly for Eximbank. Third, the Administration proposed to de-authorize the Bank's direct credit program.

We feel that, unlike its predessor, I-Match II has been sufficiently improved both technically and mechanically to be considered as an additional export financing tool by the Bank. Leading private Banks have indicated they would be willing to participate and this is the key element. CEE therefore conditionally endorses the long term I-Match II program to work in tandem with the existing direct credit program.

CEE feels the following conditions attach to its endorsement of the I-Match II concept:

First, the I-Match II program guidelines should be as presented in early drafts and made a part of the record. Among these should be:

A. The unconditional nature of the full faith and credit guarantee to private lenders.

B. The program should offer credit at rates and or terms and conditions which are fully competitive.

C. The private institutional lender must have the ability to transfer the promissory note.

D. All costs to foreign borrowers should be equivalent with those terms and conditions available under the direct credit program.

Second, and of paramount importance to CEE, the I-Match II should work in tandem with the Direct Credit Program. It should neither supplant nor deauthorize the Direct Credit Program. We believe the two programs should work side by side.

In seeking this tandem posture, we wish to note the compelling reasons for retention of a funded Direct Credit Program:

A. The Direct Credit Program has been an efficient program which can effectively support U.S. exports in international competition when properly administered.

B. I-Match II represents a significant advance in design over I-Match I. But it has yet to be tested as to its technical aspects or its competitiveness. Its success depends in large measure on the manner in which it is operated by Eximbank and the degree to which private banks participate, given changing international fiscal and economic scenaries. There would be an inevitable rough spots to be worked out. While this testing period is on-going, Direct Credits must continue to exist to assure U.S. exports of support.

C. There may be occasions when no private lending institution will bid on a particular sale. Without a Direct Credit Program that sale might be lost to the U.S. exporter. This is a particular problem with the medium-term market where many regional banks are withdrawing from the market due to low profitability and considerable regulation.

D. Maintenance of a Direct Credit Program allows Eximbank to remain a credit bank, which is of importance in its negotiations with foreign officical credit facilities in reducing or eliminating foreign subsidized rates. We echo a Commerce Department memo of last year directed at I-Match II. Commerce stated that "Unilateral action by the U.S. Government to withdraw from direct loans weakens the leverage available to the U.S. negotiators. The foreign competition will take full advantage of this situation."

E. Due to the authority limits the Administration is seeking for I-Match II of $1.8 Billion in exports, demand may exceed available resources

without a Direct Credit Program. A project may be too large or have too long a draw-down period for Eximbank to fund the full subsidy amount. In these cases, a Direct Credit Program assures continued flow of assistance to U.S. exports.

F. The Direct Credit Program may be a better vehicle for special uses, such as mixed credits, matching credits or the export expansion fund.

Third, CEE is pleased that within the last few days, Eximbank has corrected a number of deficiencies in its January 14 draft on the Medium Term I-Match Program. These new guidelines appear to contain many of the improvements sought by our members. In the spirit of continued cooperation and with the understanding that the remaining areas of concern can be addressed, CEE is prepared to support the medium term I-Match II effort as well.

Before moving from I-Match II, we need to note that there are attractive budget implications to I-Match II over the next several years. But, in the longer run, the budget implications are there due to the manner in which the current Direct Credit Program is handled in the federal unified budget. Against this comparison, I-Match II appears to present a positive effect on the budget.

Though I-Match II does have expenditures, there are benefits to the way the program is presently constituted. For one, due to the fact that its cost will be funded from Exim's reserves, the program will be off-budget and its treatment accurately reflects the way in which it should be scored - i.e. no outlays in the federal budget and therefore no pressure on the deficit. This budgeting treatment of I-Match II makes it an attractive additional tool to the Bank's export financing arsenal.

However, though we have for years expressed concern over how the credit program is treated in the unified budget, there remains great misunderstanding. For outlay purposes, it is budgeted on a cashflow basis like the rest of the federal budget - loan repayments or payments on old loans (and fees and premiums) versus disbursements for new loans. As a result, even if its loans are profitable, Eximbank will appear under current budget accounting to be adding to the deficit if the amount of its new loans is growing.

But its budget authority number is greatly misunderstood. Congress treats its budget authority as its limit on loan authority in any given year. Yet, the Office of Management and Budget considers its real budget authority to be its borrowing requirements in that year. It must receive an "appropriation" each year from the appropriations committees but it does

not draw funds from the U.S. Treasury. Yet its "limit on program activity" must compete with programs which do use appropriated tax dollars. Budget authority is charged in full for program limitations even if they are not fully utilized, as has been the case in the last several fiscal years. Thus, in fiscal year 1985, when Congress established a limitation of $3.865 billion, the appropriations committees were charged with this full amount in new budget authority, even though the Bank used less than $700 million in authority.

The Bank's budget problems are compounded by the absence of carry-over spending authority. Thus, for example, in fiscal year 1985, it had almost $3.2 billion in unused budget authority which had been fully "scored" against Eximbank in the year appropriated. This authority should be available for succeeding fiscal years when it would be used, without further appropriations action.

CEE has gave concerns about whether Eximbank should be kept as part of the unified budget, rather than moved "off-budget" to a credit budget. CEE also feels that Exim's budget authority should be saved in a way which better reflects its actual impact on the budget. But given the difficult budget environment in which Congress must act this year, CEE limits its recommendations for action to one area: carry-over authority. We recommend that Congress permit a "no year" appropriation for Eximbank on which unused budget authority can be carried-forward to succeeding years, without being scored again, or, at least, that such authority be carried over for the next succeeding fiscal year. This would help alleviate the current problem with the Bank's under-utilization of the resources Congress has given it and, yet, it would not impose an additional cost in the budget, since full budget authority would be "scored" in the initial year of the appropriation. It would also temper the annual budget battles which are so time consuming the debilitating.

I again wish to express my appreciation to this Committee for these early and timely hearings. Eximbank is an essential and needed factor in today's international competition. Without it, American exporters are at a distinct and substantial disadvantage. We thank you for your willingness to consider our suggestions for constructive changes to the Bank charter and operations.

Thank you.

Senator HEINZ. Rosemary, thank you very much.
Mr. Williams.

STATEMENT OF LARRY WILLIAMS, VICE PRESIDENT, MARKETING, CATERPILLAR TRACTOR CO., ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. WILLIAMS. Mr. Chairman, I am Larry Williams, vice president, marketing, for Caterpillar Tractor Co., and I'd like to emphasize the word "marketing" because I'm responsible for making sales happen on a worldwide basis and in response to Senator Sasser, given a level playing field, we would be very happy to take on any of the competitors around the world.

I appreciate the invitation to appear today before the subcommittee to present the views of the National Association of Manufacturers [NAM] on the issue of reauthorization of the Export-Import Bank and, as suggested, Mr. Chairman, I ask that the complete statement be entered in the record and I will be brief.

Senator HEINZ. Without objection, so ordered.

Mr. WILLIAMS. The 13,000 members of the NAM account for approximately 80 percent of U.S. industrial output and 85 percent of U.S. industrial employment. Because the bulk of U.S. exports are shipped by larger American companies, many of whom are NAM members, it is fair to say that our members account for something more than 80 percent of U.S. manufactured exports. As an aside, it goes without saying that we depend on thousands of small businessmen in the process of our efforts.

My own company, Caterpillar, has long recognized the importance of international markets. Over the last 5 years U.S. exports have accounted for an average of 34 percent of our annual sales and I'm sure if you look at the balance of payments contributions we've made they're in the top three or four historically.

TOUGH COMPETITION IN LAST 3 YEARS

But Caterpillar has faced significant international competition. At no time has this competition been stronger than during the past 3 years. After 49 consecutive years of profits, Caterpillar suffered its first loss in 1982. Spurred on by tough international competition, Caterpillar's recovery strategy centered on targeting our resources, reducing costs, developing new products, and increasing our aggressiveness in pursuing potential worldwide markets. Thankfully, profitability was restored in 1985 and we plan to make that happen in the coming years.

Now there is an uncanny parallel between Caterpillar's fortunes and those of the Eximbank. Like Caterpillar, the Bank suffered a loss in 1982—the first such loss in its 48 years of existence. Also, like Caterpillar, the Eximbank during the last several years has developed new products. Examples, some mentioned already, are new leasing programs, the Small Business Credit Programs, the Medium-Term Credit Program, and establishment of a separate marketing division within Eximbank. Eximbank has improved old programs, as evidenced by the recent decision to increase direct loan cover from 65 to 85 percent, long overdue. And it is working on correcting other weaknesses in various programs; an example of

which is the current examination of foreign content rules that Mr. Draper referred to.

The Bank has also been able to reduce costs by successfully negotiating an international agreement to automatically adjust OECD interest rates to more closely parallel market rates and that was badly needed.

But more needs to be done to improve U.S. official financing support for U.S. exporters.

The importance of official export financing can only be understood in terms of the structure of U.S. trade. Record trade deficits over the past 4 years have centered primarily in the manufacturing sector. The manufactured products deficit is projected to be around $110 billion and about three-quarters of our total trade deficit.

The prospects for reducing our trade deficit have improved with the fall of the dollar, but we will delude ourselves if we believe our Nation's international competitiveness problems will be solved by dollar decline alone. There is a wide range of other factors that are essential to improving trade performance. And Eximbank can help address one of them.

Foreign firms are not likely to give up markets they have gained over the past 4 years without a fight. In fact, as exchange rate realignment helps to close the competitive gap between U.S. and foreign firms, we can expect to see greater—and I underscore that—not less foreign reliance upon export financing to maintain market positions. Our competitors have been living in a paradise with respect to the value of the U.S. dollar vis-a-vis foreign currencies.

For example, through export insurance, guarantees, and loans, Japan has typically provided official financing equal to 35 to 40 percent of its manufactured exports. France is at 20 to 25 percent, and the United Kingdom between 35 and 40 percent. The corresponding figure for the United States has averaged between 5 and 10 percent.

Now while other nations have established aggressive official export financing programs, Eximbank, forced to reduce its budget, has reduced its support for American exports in recent years.

Nothing illustrates this point better, Mr. Chairman, than the data contained in chart 1 attached to my testimony. That's after page 5. It shows the value of U.S. exports supported by Eximbank programs as a percentage of U.S. manufactured exports for 1972 through 1985. The chart shows a dramatic fall in the level of support available to U.S. exporters. The percentage of U.S. manufactured exports supported by Eximbank declined from 28 percent in 1972 to 13 percent in 1980 to 7 percent in 1984. In fact, you raised that situation in your opening remarks.

A recent Commerce Department study on structural change in the U.S. economy contains data which demonstrates the enormous erosion in U.S. competitiveness. Chart 2, same page, shows what happened to U.S. exports. U.S. market share as a percentage of the world market dropped from 18 percent in 1960 to around 15 percent in 1970 to 11 percent in 1984, a tragedy.

It would be wrong to attribute all of the decline in U.S. export market share over the past 25 years to the decline in the level of Eximbank support. As Caterpillar has argued on many occasions

before this committee and others, a good portion of our country's competitiveness problem stems from the overvalued U.S. dollar. But there's no doubt the lack of competitive official financing support has hurt Caterpillar and NAM member companies. In fact, now that the strong dollar problem is finally receiving attention—and it's surely moving—other U.S. export problems such as foreign export financing will play an even greater role in restoring our competitiveness.

As Eximbank's charter comes up for renewal, we believe there are significant changes which can be made to increase the competitiveness of U.S. exports and halt the trend toward overseas production.

NAM SUGGESTS A 6-YEAR AUTHORIZATION

First is the issue of the length of authorization mentioned by others this morning. NAM suggests a 6-year authorization, a period sufficient to establish a sense of continuity and certainty for the exporting community.

Perhaps the most controversial issue that will be taken up by this subcommittee is the proposal by the administration to replace Eximbank's Direct Lending Program with an interest rate buydown plan, known as I-Match.

NAM views the Eximbank's Direct Lending Program as the simplest and most cost-effective method for providing this type of official financing support to American exporters.

But as long as the current budget treatment of Eximbank continues, the Direct Lending Program is in danger of further decline, if not elimination. Under these circumstances, a second best solution—for example, an interest buydown scheme—is worth considering.

In this regard, Eximbank has proposed a new version of last year's I-Match Program, known as I-Match II. It addresses many of the problems which arose in the original plan. Among the improvements: Private lenders participating in I-Match loans would presumably be able to sell these loans in the secondary markets; the bidding process to raise private sector funding has been improved; and I-Match II includes an improved Medium-Term I-Match Program, a critical area for many American exporters, Caterpillar included.

Last year we were concerned that I-Match I would be more expensive than the Direct Lending Program. This still may be the case, but certain improvements should work to reduce costs. For example, the Medium-Term Program is structured so that it can recover costs by taking advantage of favorable interest rate swings. That's impossible under the current Medium-Term Lending Program.

We differ with Eximbank, however, on their proposal to immediately discontinue funding for the Eximbank Direct Lending Program. A more prudent policy would be to keep some level of funding for this program until I-Match is up and working. There are a number of reasons to maintain authority to provide direct loan support for American exports. In fact, when we at Caterpillar un-

dertake something of this magnitude, we tend to phase it in rather than do it at one fell swoop.

First, I-Match may not be fully operational by the beginning of fiscal year 1987. With the impending departure of Chairman Draper, and the present directorship vacancy, the Eximbank board of directors will soon need to replace more than one-third of its membership. We question what effect these vacancies will have on timely implementation of I-Match II, and indeed whether a newly constructed Eximbank board will follow I-Match II outline currently under discussion.

In addition, commercial banks have not confirmed that the interest rate guarantee calculation outlined for the Medium-Term I-Match Program is acceptable. This issue must be resolved before the program can become operational.

Moreover, private sector financing may not be available, at least at reasonable costs, for the long-term projects of 15 to 20 years that are important to our Exim activity.

Finally, noneconomic, political factors may make some private lenders reluctant to participate on projects in specific countries or regions.

For all of these reasons, NAM supports maintaining direct lending authority in the Eximbank statute as well as funding for the program in fiscal year 1987.

While I-Match likely will be one of the most important issues during Exim reauthorization, there are others which deserve attention.

One such issue is mixed credits. The Eximbank has recently offered a number of mixed-credit packages aimed at countering the use of this financing practice by other nations.

Senator HEINZ. Your 10 minutes have expired. Can you summarize in 30 seconds?

Mr. WILLIAMS. Yes; I would say that the NAM is very supportive of the progress that the Eximbank has been making thus far, and reauthorization of the Eximbank charter is surely an important issue for us. In many respects, the extent to which the United States is prepared to maintain a strong Eximbank has become a barometer for our Government's interest in trade competitiveness. Eximbank must be an essential element in any credible plan aimed to restore our competitiveness on a worldwide basis.

[The complete prepared statement follows:]

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Employment Through
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COALITION FOR EMPLOYMENT THROUGH EXPORTS

Membership as of January, 1986

A. Business Organizations

1. Aerospace Industries Association of America, Inc.
2. Air Products & Chemicals, Inc.
3. Allis-Chalmers
4. American Textile Machinery Association
5. ARMCO, Inc.
6. Avco Corporation
7. Bank of America
8. Bechtel Group, Inc.
9. BF Goodrich Company
10. Blue Bird Body Company
11. The Boeing Company
12. Bucyrus-Erie Company
13. Caterpillar Tractor Company
14. Chase Manhattan Bank
15. Deere & Company
16. Dresser Industries, Inc.
17. Ducommun Incorporated
18. E.I. Du Pont De Nemours & Company
19. First Wisconsin National Bank of Milwaukee
20. Fluor Corporation
21. GATX Corporation
22. GTE Corporation
23. General Dynamics Corporation
24. General Electric Company
25. Goulds Pumps, Inc.
26. Gulf & Western
27. Hughes Aircraft Company
28. Lear Siegler, Inc.
29. McDermott Incorporated
30. McDonnell Douglas Corporation
31. Manufacturers Hanover Trust Company
32. Morgan Gueranty Trust Company
33. Morrison-Knudsen Company
34. National Association of Export Companies, Inc.
35. National Machine Tool Builders Association
36. Northrop Corporation
37. PACCAR, Inc.
38. Pennsylvania Engineering Corporation
39. Pneumo Corporation
40. Raytheon Company
41. Rockwell International
42. Rohr Industries, Inc.
43. The Signal Companies
44. Sperry Corporation
45. Stone & Webster Engineering Corporation
46. Sundstrand Corporation
47. Textron Incorporated
48. Transamerica Delaval Incorporated
49. United Technologies
50. U.S. Steel Corporation
51. Wean United
52. Westinghouse Electric Corporation

B. Labor Organizations

1. American Federation of Government Employees
2. Building and Construction Trades Department, AFL-CIO
3. Coalition of Labor Union Women
4. Communications Workers of America
5. Council of Engineers and Scientists Organizations
6. International Brotherhood of Electrical Workers
7. International Ladies' Garment Workers Union
8. International Union of Electrical, Radio and Machine Workers
9. International Union of Operating Engineers
10. The Seafarers International Union of North America, AFL-CIO
11. United Association of Plumbers and Pipefitters
12. United Automobile, Aerospace and Agricultural Implement Workers of America
13. United Brotherhood of Carpenters and Joiners of America
14. United Steelworkers of America

C. Governors

1. Governor Bob Graham of Florida
2. Governor Bruce Babbitt of Arizona
3. Governor William A. O'Neill of Connecticut
4. Governor George R. Ariyoshi of Hawaii

5. Governor John V. Evans of Idaho
6. Governor James R. Thompson of Illinois
7. Governor John Carlin of Kansas
8. Governor Harry Hughes of Maryland
9. Governor Rudy Perpich of Minnesota
10. Governor Victor G. Atiyeh of Oregon
11. Governor Dick Thornburgh of Pennsylvania
12. Governor William J. Janklow of South Dakota

National Association of Manufacturers

STATEMENT OF

LARRY WILLIAMS
VICE PRESIDENT, CATERPILLAR TRACTOR COMPANY

ON BEHALF OF
THE NATIONAL ASSOCIATION OF MANUFACTURERS
REGARDING
1986 REAUTHORIZATION OF THE EXPORT-IMPORT BANK

BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE & MONETARY POLICY
OF THE
SENATE BANKING COMMITTEE

FEBRUARY 7, 1986

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STATEMENT OF

LARRY WILLIAMS

VICE PRESIDENT, CATERPILLAR TRACTOR CO.

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1986 REAUTHORIZATION OF THE EXPORT-IMPORT BANK

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SUBCOMMITTEE ON INTERNATIONAL FINANCE & MONETARY POLICY

OF THE

SENATE BANKING COMMITTEE

Mr. Chairman, members of the Subcommittee, I am Larry Williams, Vice President, Caterpillar Tractor Co. I appreciate the invitation to appear today before the Subcommittee to present the views of the National Association of Manufacturers on the issue of reauthorization of the Export-Import Bank. I have a complete statement which I ask be entered in the record. In the interest of time I will briefly summarize the key points of that text.

The 13,000 members of the NAM account for approximately 80 percent of U.S. industrial output and 85 percent of U.S. industrial employment. Because the bulk of U.S. exports are shipped by larger American companies, many of whom

are NAM members, it is fair to say that our members account for something more than 80 percent of U.S. manufactured exports. In practical terms, NAM's concern for U.S. international competitiveness is second only to our concern for the strength of the U.S. industrial base. Indeed, because U.S. exports 20 percent of its industrial output, the two issues cannot be separated.

My own company, Caterpillar, has long recognized the importance of international markets. Over the last five years U.S. exports have accounted for an average of 34 percent of our annual sales.

But Caterpillar has faced significant international competition. At no time has this competition been stronger than during the past three years. After 49 consecutive years of profits, Caterpillar suffered its first loss in 1982. Spurred on by tough international competition, Caterpillar's recovery strategy centered on targeting our resources, reducing costs, developing new products, and increasing our aggressiveness in pursuing potential worldwide markets. Profitability was restored in 1985.

There is an uncanny parallel between Caterpillar's fortunes and those of the Eximbank. Like Caterpillar, the Bank suffered a loss in 1982 -- the first such loss in its 48 years of existence. Also, like Caterpillar, the Eximbank during the last several years has developed new products. Examples are: new leasing programs; the small business credit programs; the medium term credit program; and establishment of a separate marketing division within Eximbank. Eximbank has improved old programs, as evidenced by the recent decision to increase direct loan cover from 65 to 85 percent. And it is working on

correcting other weaknesses in various programs; an example of which is the current examination of foreign content rules.

The Bank has also been able to reduce costs by successfully negotiating an international agreement to automatically adjust OECD interest rates to more closely parallel market rates.

But more needs to be done to improve U.S. official financing support for U.S. exporters.

Case for Eximbank

The importance of official export financing can only be understood in terms of the structure of U.S. trade. Record trade deficits over the past four years have centered primarily in the manufacturing sector. In 1986, the manufactured products deficit will be around $110 billion ... about three-quarters of our total trade deficit. The U.S. cannot work its way out of this situation unless a dramatic increase is achieved in the international competitiveness of U.S. manufacturers. We need to increase our ability to compete with foreign products here in our domestic market. Equally important, foreign market shares lost during the era of the "super" dollar will have to be recaptured.

The prospects for reducing our trade deficit have improved with the fall of the dollar since September 1985. But we will delude ourselves if we believe our nation's international competitiveness problems will be solved by dollar

decline alone. There is a wide range of other factors that are essential to improving trade performance. Eximbank can help address one of them.

Foreign firms are not likely to give up markets they have gained over the past four years without a fight. In fact, as exchange rate realignment helps to close the competitive gap between U.S. and foreign firms, we can expect to see greater, not less, foreign reliance upon export financing to maintain market positions.

Other major industrial nations, and a growing number of developing nations, have long recognized the importance of official export financing support. In many ways, what the U.S. has done in terms of financial support for its domestic housing industry (e.g., VA and FHA loans), other industrial nations have done for their export industries. Our major competitors have established finance programs which provide strong support to export industries. For example, through export insurance, guarantees, and loans, Japan has typically provided official financing equal to 35-40 percent of its manufactured exports, France is at 20-25 percent, and the United Kingdom between 35-40 percent. The corresponding figure for the U.S. has averaged between 5-10 percent.

Of the major industrial countries, only West Germany has as modest an official financing program as the U.S. — providing support equal to about 10 percent of their manufactured exports. Because West Germany has become the world's leading exporter of manufactured goods, some might conclude from this example that government's role in export finance is not an important determinant of international competitiveness.

But this ignores the special relationship between German commercial banks and German industry that ensures adequate financing for German exports. According to a 1981 Eximbank report to Congress, "It can be argued that, given the special role commercial banks play in the overall German economy, direct official support is not necessary".

While other nations have established aggressive official export financing programs, Eximbank, forced to reduce its budget, has reduced its support for American exports in recent years.

Nothing illustrates this point better than the data contained in Chart 1 attached to my testimony. It shows the value of U.S. exports supported by Eximbank programs as a percentage of U.S. manufactured exports for 1972 through 1985. The Chart shows a dramatic fall in the level of support available to U.S. exporters. The percentage of U.S. manufactured exports supported by Eximbank declined from 28 percent in 1972 to 13 percent in 1980 to 7 percent in 1984.

During this same period, U.S. manufactured exports nevertheless grew from $34 billion to $151 billion. In other words, significant export growth occurred without increased Eximbank support. However, we must look beyond these figures to changes in U.S. export market shares for a true picture of U.S. export performance.

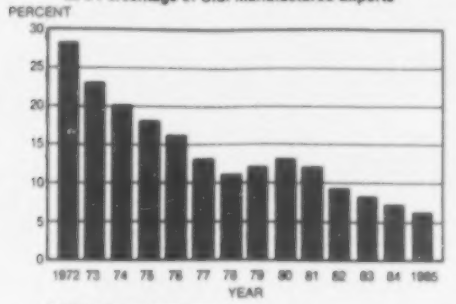
A recent Commerce Department study on structural change in the U.S. economy contains data which demonstrates the enormous erosion in U.S. competitiveness.

Senator HEINZ. Thank you very much.
Ms. Harsanyi.

STATEMENT OF FRUZSINA M. HARSANYI, DIRECTOR, INTERNATIONAL GOVERNMENT AFFAIRS, COMBUSTION ENGINEERING, INC., ON BEHALF OF NATIONAL FOREIGN TRADE COUNCIL

[The complete prepared statement follows:]

CHART 1: The Value of U.S. Exports Supported by Exim Programs as a Percentage of U.S. Manufactured Exports



By NAM from Eximbank Annual Reports
Data for 1977 includes Exim Programs during the transition quarter between FY 1976 and FY 1977

CHART 2: U.S. Share of World Exports

By NAM from Commerce Department data

Chart #2 shows what happened to U.S. exports -- U.S. market share as a percent of the world market dropped from 18 percent in 1960 to around 15 percent in 1970 to 11 percent in 1984.

It would be wrong to attribute all of the decline in U.S. export market share over the past 25 years to the decline in the level of Eximbank support. As Caterpillar has argued on many occasions, a good portion of our country's competitiveness problem stems from the overvalued U.S. dollar. But there's no doubt that the lack of competitive official financing support has hurt Caterpillar and NAM member companies. In fact, now that the strong dollar problem is finally receiving attention, other U.S. export problems such as foreign export financing will play an even greater role in restoring our competitiveness.

These two conditions have had a direct impact on the U.S. economy because in order to maintain competitiveness many American companies have been forced to shift production and jobs to foreign subsidiaries. In 1980, 57 percent of Caterpillar's world wide sales were outside the U.S. and 24 percent of our employment was non-U.S. In 1985, foreign sales declined to '4 percent while overseas employment increased to 30 percent." A recent NAM survey of nearly 50 U.S. exporters found that 63 percent of these companies supplied goods from foreign plants because the host country provided more effective export credit facilities.

Eximbank Reauthorization

As Eximbank's charter comes up for renewal, we believe there are significant changes which can be made to increase the competitiveness of U.S. exports and halt this trend toward overseas production.

First is the issue of the length of the authorization. NAM suggests a six year authorization ... a period sufficient to establish a sense of continuity and certainty for the exporting community.

Perhaps the most controversial issue that will be taken up by this Subcommittee is the proposal by the Administration to replace Eximbank's direct lending programs with an interest rate buydown plan, known as I-Match. As you know the direct lending program includes not only direct credits but also the medium term and small business credit programs. Collectively, in 1985, these two programs had a higher usage level than the direct credit program.

NAM views the Eximbank's direct lending programs as the simplest and most cost effective method for providing this type of official financing support to American exporters. But at the same time, we also recognize the way in which the Eximbank is included in the Federal budget puts the Bank's funding in constant jeopardy, despite the fact that Eximbank authorizations are not expenditures but rather loans repaid with interest.

As long as the current budget treatment of Eximbank continues, the direct lending program is in danger of further decline, if not elimination. Under

these circumstances, a second best solution -- an interest buydown scheme -- is worth considering.

Eximbank has proposed a new version of last year's I-Match program -- known as I-Match 2. It addresses many of the problems which arose in the original plan. In viewing I-Match 1, exporters and bankers were concerned by the mechanics of the proposal and whether it would actually work in practice as well as in theory. These problems appear to have been adequately addressed in the newly outlined plan. Among the improvements:

-- Private lenders participating in I-Match loans would presumably be able to sell these loans in secondary markets.
-- The bidding process to raise private sector funding has been improved, and
-- I-Match 2 includes an improved medium-term I-Match program, a critical area for many American exporters, Caterpillar included.

Last year we were concerned that I-Match 1 would be more expensive than the direct lending program. This still may be the case, but certain improvements should work to reduce costs. For example, the medium term program is structured so that it can recover costs by taking advantage of favorable interest rate swings. That's impossible under the current medium-term lending program.

Eximbank officials have devoted significant resources to developing the details of I-Match 2. And because we believe they are committed to making it work, we're prepared to support the effort.

We differ with Eximbank, however, on their proposal to immediately discontinue funding for the Eximbank direct lending program. A more prudent policy would be to keep some level of funding for this program until I-Match is up and working. There are a number of reasons to maintain authority to provide direct loan support for American exports:

First, I-Match may not be fully operational by the beginning of FY1987. With the impending departure of Chairman Draper, and the present directorship vacancy, the Eximbank board of directors will soon need to replace one-third of its membership. We question what effect these vacancies will have on timely implementation of I-Match 2, and indeed whether a newly constructed Eximbank board will follow the I-Match 2 outline currently under discussion.

In addition, commercial banks have not confirmed that the interest rate guarantee calculation outlined for the medium-term I-Match program is acceptable. This issue must be resolved before the program can become operational.

Moreover, private sector financing may not be available, at least at reasonable costs, for long term projects of 15-20 years.

Finally, non-economic, political factors may make some private lenders reluctant to participate on projects in specific countries or regions.

For all of these reasons, NAM supports maintaining direct lending authority in the Eximbank statute but also funding for the program in FY 1987.

While I-Match likely will be one of the most important issues during Exim reauthorization, there are others which deserve attention:

Mixed credits -- The Eximbank has recently offered a number of mixed credit packages aimed at countering the use of this financing practice by other nations. This new aggressiveness on the part of the Bank is a welcome development. It is, of course, connected with the Administration's request for legislation to establish a $300 million mixed credit "war chest". NAM supports this legislation. We have worked with the staff of this subcommittee on its details and hope that it will soon be reported out of the Banking Committee to the full Senate.

The present Eximbank statute, as you well know, Mr. Chairman, includes authority for the Eximbank and the Agency for International Development (AID) to cooperate in developing mixed credit packages to support U.S. exports. The mixed credit provisions in the current law were passed during the 1983 Eximbank reauthorization. Unfortunately, the mixed credit program set up in 1983 has not been utilized to the extent that the business community had hoped it would be.

One of the problems is that current law limits AID to using only the funds available in its Commodity Import Programs. NAM favors the elimination of this restriction so that money in AID's Economic Support Fund (ESF) could be used for mixed credits.

Given the seriousness of U.S. international competitiveness problems, we think it is reasonable for AID to use part of its nearly $4 billion Economic Support Fund (ESF) to support U.S. mixed credit packages. This action in no way would diminish AID funding for humanitarian purposes. ESF, set up 34 years ago, has undergone many title changes, but its purpose has always been to support activities considered ineligible or inappropriate for funding under other foreign aid accounts.

Competitiveness mandate -- One of the major changes accomplished in the 1983 Eximbank reauthorization was the inclusion of a competitive mandate in the Eximbank statute. Whether this mandate has made a difference in Eximbank operations is difficult to determine. In the 1984 NAM survey mentioned earlier, 10 percent of the respondents felt that the Bank was not carrying out its competitive mandate "at all" and 53 percent felt that it was doing so "inadequately". Only 20 percent of the respondents felt that Exim was "adequately" meeting the test.

NAM realizes that no matter how the competitiveness mandate is drafted its impact on Eximbank operations will be more hortatory than real. Nevertheless, we support a refinement in the mandate to emphasize that as a matter of standard practice the Bank's programs should be available on the best terms allowable under the OECD guidelines governing official financing practices.

Risk assumption -- In many countries throughout the world, Eximbank will not engage in new loan commitments, even though major overseas competitors are able to obtain official financing support from their governments. In the case

of many countries, the Bank's standards for "reasonable assurance of payment" effectively closes the door to American companies trying to do business in these markets. For example, Eximbank recently denied an application from a new private sector company in Chile. At stake was the sale of Caterpillar equipment for a mine project which would provide coal for Chilean consumption, replacing fuel oil imports. Canadian and possibly German export financing facilities agreed to provide financing without a Chilean government guarantee. International Finance Corporation (IFC), the World Bank's sister organization, also agreed. Our own Eximbank refused to provide the required financing.

In such cases it would be preferable for the Bank to examine loan applications from the standard of "reasonable expectation", rather than "assurance", that they will be repaid. We urge the Subcommittee to request that the Bank study this possibility and report back on how such a change would affect their operations. We would also suggest that the Congress request that the Bank in its annual competitiveness report provide a list of countries where official financing was being offered by other nations, but not by the Eximbank. This report should also list any applications formally considered and denied by Eximbank for customers to whom assistance was ultimately offered by a foreign country.

Loan coverage -- The Eximbank has recently increased from 65 percent to 85 percent the amount of an export transaction that will be covered in its direct loan program. NAM supports this effort by the Bank to improve the competitiveness of its programs and we want to call this support to the attention of the subcommittee. Another issue which Eximbank could usefully

address includes financing for local costs on projects. Such financing could be restricted to purchases of U.S. products.

2 Percent Fee -- In 1981, the Eximbank announced a 2 percent application fee that was to be charged on all loans made by the Bank. The purpose of this fee, as outlined in an Eximbank press release, was "to improve the Bank's net income immediately". The Eximbank has argued since the implementation of the fee that it represents a relatively low level cost compared to the insurance premiums of our major trade competitors. There has been a great deal of debate as to whether the 2 percent fee for comparison purposes should be considered an insurance premium or a bank management fee charged by commercial banks participating in official foreign financing deals.

Regardless of whether this 2 percent fee is considered an insurance premium or bank fee, U.S. companies are disadvantaged. If it is a bank fee, as many foreign customers think it is, then it is 4-5 times higher than what our competition charges. If it is an insurance premium, then Eximbank is penalizing the most credit worthy by charging a flat rate for everyone regardless of risk. Other nations, moreover, often have the flexibility in their official financing systems to drop insurance fees down to whatever level necessary to compete for business on key projects.

NAM has long favored the elimination of the 2 percent fee. We hope that this Subcommittee examines this issue with Eximbank in some detail during the reauthorization debate.

Leasing program -- The Eximbank has also recently announced a new program to support the leasing of American products by foreign customers. This new program is an important step toward bringing Eximbank services into line with international commercial realities. In many cases, leasing is the principal way in which products are "sold" to international customers. NAM applauds the initiative of the Bank in developing this new program.

Advisory committee -- In 1983, Congress directed the Eximbank to establish a private sector advisory committee which was to meet on a regular basis with Eximbank officials to advise the Bank on its programs. NAM feels that this Advisory Committee has served a useful purpose in looking at very general issues involved in Eximbank policy and operations. We think the advisory system would be improved if some means were found to involve private sector representatives who have more technical knowledge of international finance and Eximbank programs. The Bank does assemble on an ad hoc basis various expert advisory groups to deal with specific issues. We believe that a more permanent technical advisory committee, required to meet on a regular basis, would serve as a useful link between American exporters and the Eximbank.

International negotiations -- In 1983, the OECD arrangement was modified to provide for semiannual adjustments of interest rates. This was a milestone in these negotiations which has helped to rein in official financing practices by certain foreign governments, at least in terms of competition over interest rates. In fact, without this OECD arrangement, it is hard to see how an I-Match program as proposed by the Administration could be operated with reasonable costs.

Earlier, I mentioned that official support was equal to 35-40 percent of Japanese manufactured exports, 20-25 percent for France, and 35-40 percent for the U.K. As far as we know, the U.S. has never pressed in the OECD negotiations to reduce these levels of support. Instead, we have concentrated on restricting the terms, not the quantity of loans offered. NAM feels that we need to address the issue of the amount of support being provided by other official financing programs.

We are also increasingly concerned by the degree to which Japan continues to provide this kind of support. In the late 1970s, Japan's aggressive export financing policies could be understood as an expression of her need to insure adequate export earnings to cover increasingly costly natural resource imports. But the level of support noted above occurred in a period of falling natural resource prices and a depreciating yen. Under these conditions, it is puzzling that Japan, with her large trade surpluses, has not cut back on export credits. One would expect Japanese officials to see the potential that withdrawing government support in this area represents: an opportunity to relieve some of the strain on the international trading system. We believe Japanese companies should be forced to compete in overseas markets without extraordinary government backing.

Conclusion

I would like to thank the Committee for the opportunity to testify today. The reauthorization of the Eximbank is an important issue for the NAM and Caterpillar Tractor. Co. In many respects the extent to which the U.S. is prepared to maintain a strong Eximbank has become a barometer for our govern-

ment's interest in trade competitiveness. Eximbank must be an essential element in any credible plan aimed to restore our competitiveness in world export markets.

Senator HEINZ. Dr. Harsanyi, thank you very much.
Mr. Velden.

STATEMENT OF AXEL VELDEN, DIRECTOR, JOHNSON & JOHNSON EXPORT DIVISION, ON BEHALF OF EMERGENCY COMMITTEE FOR AMERICAN TRADE

Mr. VELDEN. Mr. Chairman and Mr. Proxmire, thank you for the opportunity to appear before you today on behalf of the Emergency Committee for American Trade [ECAT] in connection with Eximbank reauthorization legislation.

My name is Axel Velden. I am director of the Johnson & Johnson Export Division. A written statement has been submitted for the record and I will briefly summarize that now.

ECAT supports a strong Export-Import Bank that will be able to continue its role of financing U.S. exports. Without Eximbank, a number of ECAT members would have lost many billions of dollars of export sales in recent years. We are concerned that sales may be lost in future years if adequate lending authority for the Bank is not maintained.

Consequently, ECAT supports a 6-year extension of the Eximbank charter through September 30, 1992. This will ensure that its programs will continue to be available for U.S. exporters.

Last year's foreign trade deficit of nearly $150 billion is frightening. The 1986 trade deficit is expected to be even larger. Cutting out the Eximbank direct lending authority as proposed in the President's fiscal year 1987 budget is not advisable. Exporters will suffer and jobs will be placed at risk. ECAT urges Congress to continue to support the Direct Credit Program at its current authorized level of $1.1 billion.

American business is under seige from very effective foreign competitors, many of whom are subsidized by their governments. U.S. share of world markets is barely holding its own. While we are doing what we can to increase our trading capabilities as much as possible, we can use any help we can get from our Government to meet the many foreign competitive challenges facing the American business community.

ECAT CONCERNED ABOUT I-MATCH

ECAT has some concerns about the administration's proposal to establish an Interest-Matching Program, I-Match, in place of the Direct Lending Program. The necessary funds to match the difference between the commercially available domestic interest rates and the foreign interest rates will come from the Bank's reserves. We don't know what the effect of this will be on future budgeting of the Bank.

Another consideration is the cost of the program. Some estimates place the cost considerably higher than that of the Bank's loan operations.

There is also the possibility that the I-Match Program will not be able to generate the necessary financing to meet an Eximbank commitment. Such a contingency could be handled if back up authority for direct loans remains intact.

ECAT believes I-Match should first be given a test as a supplement to the Direct Credit Program.

I would also like to comment briefly on the Eximbank's role in mixed-credits. From ECAT's perspective, it is essential that the Bank have the resources to combat mixed-credit practices of foreign governments.

EXIM'S HELP IN $44 MILLION ORDER

A recent experience of Johnson & Johnson illustrates that point. In 1985, we were successful in securing a $44 million order for hospital equipment destined for a number of hospital systems in the State of Sao Paulo, Brazil. Johnson & Johnson coordinated this project and obtained participation from approximately 40 different U.S. equipment manufacturers to put together the final order.

This project could not have gone forward without support from the Eximbank. The French have targeted the hospital equipment market in Brazil and have captured leadership. This was accomplished exclusively through mixed-credit umbrella agreements negotiated annually since 1982. Our customers informed us that the French manufacturer was bidding for the same business as we were, offering extremely concessionary terms, including 2 percent interest on a part of the costs and very extended payment terms. Our only chance was to persuade Eximbank to match the French financing package as closely as possible. The Bank did so and the U.S. consortium has now entered into final contract negotiations.

This result was critically important to us and to the other suppliers involved because of the nature of the equipment involved. The vast majority of items destined for Brazil in this package consists of state-of-the-art diagnostic equipment, including magnetic resonance imagery. Johnson & Johnson is a leader in this technology, having obtained FDA approval in 1984. These items represent millions of dollars in research and development costs that cannot be fully recovered in U.S. sales alone.

Mr. Chairman, we realize that past U.S. efforts to counteract foreign mixed-credit competition have only been partly successful. Japan, West Germany, and France have not shown a willingness to abandon the practice and continue to siphon off attractive American export opportunities around the world.

Resources to combat interest subsidies are scarce and are likely to become completely unavailable in the present cost-cutting climate. Nonetheless, we are gratified that Eximbank saw the Brazilian market situation as one that required aggressive action. We hope that the Bank will continue to show a willingness to battle mixed export credits around the world.

We would not be able to regain this lost market in Brazil without an institution like Eximbank that has U.S. exports as its primary mission. We understand the hard choices Congress must make in the present budget situation, but we also see a tremendous potential for exporting the products of our medical technology if we can discourage foreign competitors from tipping the scales with government subsidies.

Medical technology offers unique opportunities for export growth because it is among the last areas in which the United States

enjoys world leadership. Our competitors realize this because otherwise they would not perceive a need to offer major financing concessions. They do so because on even terms they know we would beat them every time.

Mr. Chairman, we urge Congress to renew the authority of Eximbank for 6 years, to maintain Eximbank's mandate for direct credits at the current authorized level of $1.1 billion, to allow a trial run for the I-Match Program, and, within limits prescribed by the deficit situation, continue to encourage its active participation in fighting off mixed credits. Only if the playing field is even can Johnson & Johnson and the other ECAT companies maintain the strong presence in world markets of which they are truly capable.

Thank you.

[The complete prepared statement follows:]

NATIONAL FOREIGN TRADE COUNCIL, INC.
900 17th STREET, N.W., WASHINGTON, DC 20006 (202) 887-0278

STATEMENT BY DR. FRUZSINA HARSANYI

NATIONAL FOREIGN TRADE COUNCIL

BEFORE THE SENATE COMMITTEE ON BANKING,

HOUSING AND URBAN AFFAIRS

HEARING ON THE CHARTER RENEWAL OF EXPORT-IMPORT BANK

FEBRUARY 7, 1986

I am Fruzsina Harsanyi, Director, International Government Affairs, Combustion Engineering and am appearing today on behalf of the National Foreign Trade Council (NFTC). The National Foreign Trade Council is composed of over 500 U.S. corporations engaged in foreign trade and investment, including most of the major exporting companies of the country. The Council's Export Finance Committee, of which I am a member, has long supported a strong and effective Eximbank.

The Council appreciates the opportunity to testify before this committee which has a long-standing commitment to a strong, competitive Export-Import Bank. We commend Senator Heinz for his unflagging leadership in helping U.S. exporters to combat predatory financing practices of foreign governments. Because of Senator Heinz's efforts there is an increased awareness in the Congress and the Administration of the devastating effects foreign export credit subsidies have on U.S. jobs and our nation's long-term competitiveness. More importantly, the efforts of this committee are clearly linked to more competitive policies within Eximbank and to improved international agreements limiting export credit subsidies.

My primary purpose in testifying today is to present the Council's views to the on the reauthorization of Eximbank's charter and on proposed changes in the bank's credit programs. How these issues are resolved in the Congress will determine our future progress in eliminating foreign export credit subsidies.

Mr. Chairman, the National Foreign Trade Council strongly urges the Congress to extend the statutory life of Eximbank for six years to September 30, 1992. We believe the time is ripe for a clear, ringing statement of support for the Bank. One of the best ways for Congress to show that support is to grant a significant charter extension. Continual short extensions merely sow seeds of doubt in our own export community and give encouragement to our competitors abroad regarding Congress' intentions about U.S. export promotion. At the same time, a long extension in no way effects this Committee's ability to monitor the Bank's activities by means of periodic oversight hearings. We can, therefore, have both a major show of support for the institution and its objectives, and a means of following closely its programs and policies.

The Council believes, however, that a charter extension without adequate means to assist in financing exports would be an empty gesture. That brings us to the Administration's proposal for an interest subsidy (I-Match) program as a substitute for direct lending. We must state at the outset that we much prefer a fully-funded credit program. That would be the least expensive method for the U.S. taxpayer to support an export loan program. However, the Council recognizes that additional reduction in the Federal budget deficit is a high priority for the Congress and the Administration.

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After careful review of the new interest subsidy proposal, the Council believes that it can adequately serve as a substitute for a substantial portion of the existing and time-tested direct credit program. Obviously this conclusion is subject to review of the legal documentation of the new I-Match plan; but from what we have heard and seen, we believe Eximbank and the Administration have met most of the technical objections which existed in the first interest subsidy scheme proposed last year.

The Council believes, however, that I-Match alone is not enough and a significant level of the direct credit program should be retained. An interest subsidy approach is unlikely to provide fully competitive support in all cases -- especially in regard to mixed credits. Furthermore, I-Match is untested in the financial markets. To make sure that Eximbank remains a credible source of export finance until I-Match is a proven success, adequate credit authority should remain. The Council, therefore, supports an interest subsidy program of $1.8 billion and a direct credit authorization of $850 million. This proposal would result in an Eximbank budget reduction of 78 percent -- approximately $3 billion -- from Fiscal Year 1985. Further, in order to maximize the budget reducing effect of I-Match, the Bank should use this program to the fullest extent practicable before it uses any direct credit authority.

I would like to qualify our general support for I-Match as it relates to Eximbank's medium term export credit program. Eximbank's medium term guarantee and credit programs are in some ways more complex than the long term direct credit program and there are, understandably, more technical problems to be solved. We have given Eximbank detailed comments on medium term I-Match and hope the issues we have raised will be resolved satisfactorily.

The Export Finance Committee of the Council has had several meetings and has conducted an intensive review of Eximbank's re-chartering. After thorough study and discussion of many issues that could be raised in the context of Exim's statutory extension, the Council concluded that it should limit its comments to only a few, basic matters. We believe it is far more important to renew the Bank's charter quickly and with a minimum of baggage. We, therefore, have only one legislative amendment to propose and three policies which we believe the Bank should modify.

The statutory provision which we propose to amend is Section 1912 of the Export-Import Bank Act Amendments of 1978. This law provides for a means to match predatory financing offered to buyers in the U.S. by countries with which the U.S. has export credit arrangements. Some Council members are encountering this kind of competition from countries with which the U.S. does not have such arrangements. Therefore, the Council urges an amendment to

Section 1912 which would include any country offering financing which exceeds limits under existing standstills, minutes, or practices whether or not that country is a party to the arrangement itself.

Now for the policy issues. In 1983, Congress, led in large part by this Committee, amended the Bank's charter to emphasize and clarify its legislative mandate to meet foreign officially supported competition. While improvements have been made by the Bank, the issue is still very much with us; and there are three specific policies of the Bank which our members believe should be modified in order for the Bank to meet its competitiveness mandate.

First, there is the issue of financing foreign content and local costs. Other export credit agencies are generally willing to provide assistance for foreign content and local costs to a far greater degree than Eximbank. While Eximbank has been willing to provide a guarantee for local costs up to fifteen percent of the contract price to meet competition, it is unduly difficult to convince the Bank that it is needed in specific cases. As for foreign content, it provides virtually no assistance in its long term direct credit and financial guarantee programs and up to ten percent in its medium term programs. Europe, Canada and Japan will cover much more, ranging from ten percent to fifty percent depending on the country and the case. Eximbank should meet that competition. In today's world, purchasing countries require a substantial local component in domestic projects, and U.S. manufacturers are finding it economically necessary to enter into joint manufacturing agreements with companies abroad for manufacture of a portion of their product. A liberalization of Eximbank's policy on foreign content and local costs would go a long way to help the exportation of products which are primarily manufactured or produced in the U.S.

Second, the problem of tied aid credits continues to be a major concern to American companies. Eximbank has had a legislative direction to provide a tied aid credit program since 1983 but has been responsive to this legislation only in recent months. While there are several bills pending to provide appropriations for Eximbank to meet this predatory competition, Eximbank's responsiveness should not be contingent upon current legislative activities. Eximbank should continue the efforts it began a few months ago. Eximbank already has sufficient, explicit statutory authority to provide tied aid credits and should do so whenever necessary to meet the competition. Both the new legislative initiative and action under existing statutory authority are necessary to bring a negotiated end to tied aid credit abuses.

Finally, there still remains the bank's highly objectionable two percent up front application fee. While it is difficult to prove this fee loses sales, we can with certainty state that it is a great

irritant to foreign buyers and adds significantly to U.S. exporters' difficulty in closing a sale. There is no clear need for this fee, and it should be dropped; but at least if it must continue, the fee should be amortized over the full life of the underlying credit.

Thank you for receiving my testimony today and I would be happy to answer any questions the committee may have.

STATEMENT OF AXEL O. VELDEN,
DIRECTOR, JOHNSON & JOHNSON EXPORT DIVISION,
ON BEHALF OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
OF THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
ON THE
RENEWAL OF THE EXPORT-IMPORT BANK ACT OF 1945

February 7, 1985

Mr. Chairman and members of the Committee, I am Axel O. Velden, Director of the Johnson & Johnson Export Division, and I am appearing on behalf of the Emergency Committee for American Trade (ECAT). Johnson & Johnson is a diversified health care products manufacturer with annual worldwide sales of approximately $6 billion. We exported approximately $50 million in volume last year and together with the other ECAT members have a keen interest in the Export-Import Bank.

ECAT is an organization of the leaders of 62 large U.S. business firms with extensive overseas business interests. ECAT member companies had 1985 worldwide sales of approximately $700 billion and employed over five million people. ECAT's purpose is to advocate and support policies that will expand U.S. international commerce.

We appreciate the opportunity to appear before you and express our support for a viable Export-Import Bank that will be able to continue its valued and historic role of financing U.S. exports. Without the lending and other facilities of the Eximbank, a number of ECAT member companies would very likely have lost many billions of dollars of export sales over recent years. We are concerned that many billions of dollars of prospective export sales may be lost in future years without an adequate lending authority for the Eximbank. ECAT

supports a six-year extension of the Eximbank Charter through September 30, 1992, to ensure that the programs of the Eximbank continue to be available for U.S. exporters.

Last year's foreign trade deficit of nearly $150 billion is frightening. The 1986 trade deficit is expected to be even larger. Cutting out the Eximbank direct lending authority as proposed in the President's fiscal year 1987 budget is not advisable. Our exports will suffer and jobs may be placed at risk. ECAT urges the Congress to continue to support the direct credit program at its current authorized level of $1.1 billion.

American business both at home and abroad is under seige from very effective foreign competitors. The U.S. share of the world market is barely holding its own. We in business are doing what we can to increase our productive efficiencies in order to survive and prosper in the world marketplace.

We need and appreciate any help we can get from our government to meet the many foreign competitive challenges facing the American business community.

We have concerns about proposals to diminish the Eximbank's authorities to facilitate U.S. exports. These proposals appear to be revenue-driven, written in the shadows of the federal budget deficit.

Mr. Chairman, try to imagine the government of Japan handicapping its exporters in the manner of the Administration's Eximbank proposals!

THE INTEREST-MATCHING PROGRAM

ECAT has some basic concerns about the Administration's proposal to rely on an interest-matching program (I-Match) in place of a direct Eximbank lending program, particularly since the necessary funds to

match the difference between the commercially available domestic interest rates and the foreign interest rates will come from the reserves of the Eximbank. Our concern is heightened by the Comptroller General's May 29, 1985, report to the Congress in which it is concluded that:

> "The Bank's financial statements do not include an allowance for estimated losses that are likely to be sustained due to the uncollectibility of a portion of the loans it has made. If such an allowance had been deducted, GAO estimates that the Bank's equity would have been decreased by $1.0 to $1.5 billion, eliminating substantially all of the $1.4 billion in equity accumulated from the Bank's results of operations."

Another question that we have about the proposed interest-equalization program is its cost. Some estimates place the cost considerably higher than that of the Bank's loan operations.

There is also the outside chance that the I-Match program will fail in a given instance to generate the necessary financing to meet an Eximbank commitment. Such a contingency, however remote, could be handled if back up authority for direct loans remains intact.

ECAT members question whether the I-Match program is ready for full implementation. We believe that it should first be given a trial run as a supplement to the direct credit program. A trial run would provide an opportunity to compare the outcomes under I-Match and a continuing Eximbank direct credit program in actual financing undertakings.

MIXED CREDITS

I would like to comment on the Eximbank's role in mixed credits. From the perspective of Johnson & Johnson and other members of ECAT, it is essential that the Eximbank have the resources to combat the mixed credit practices of foreign governments.

A recent Brazilian experience of Johnson & Johnson illustrates the point.

In 1985 Johnson & Johnson was successful in securing a $44 million order for hospital equipment destined for a number of hospital systems in the State of Sao Paulo, Brazil. Johnson & Johnson coordinated this project and obtained participation from approximately 40 different U.S. equipment manufacturers in putting together the final order.

This project, however, could not have gone forward without support from the Eximbank. Through mixed credits, the French have taken over leadership in the hospital equipment market in Brazil. The Brazilian customers informed us that a French manufacturer was bidding for the hospital equipment contract, offering extremely concessionary terms, including two percent interest on a part of the costs as well as extended payment terms. The only chance was to persuade Eximbank to match the French financing package as closely as possible. The Bank did so and the U.S. consortium has now entered into final contract negotiations.

The result is critically important to Johnson & Johnson and the other suppliers because of the nature of the equipment involved. The vast majority of items destined for Brazil in this package consists of state-of-the-art diagnostic equipment, including magnetic resonance

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RELUCTANT ENDORSEMENT OF I-MATCH

Senator HEINZ. Mr. Velden, thank you very much.

I have a few questions for you. Each of you has reluctantly endorsed the I-Match Program saying you want to cooperate, but on a trial basis. Keep the Direct Credit Program but test market the I-Match Program.

I suspect that we may run into some difficulties in trying to enact a second Government program on top of an existing Government program. Someone might interpret that as two bites at the apple. We're likely to end up with one or the other, but it is unlikely that we are going to end up with both, I would guess. I could be wrong.

Now, you have all more or less said I-Match is worth a try. One or two of you said it's a second-best approach.

Do you see more effective or less costly alternatives or both to I-Match that are different from the present program?

Rosemary, I'll start with you because you're a former Eximer.

Ms. MAZON. Well, first of all, the Direct Credit Program has been cut from $3.8 billion in fiscal year 1985 to $1.1 billion in fiscal year 1986 and even that figure, the $1.1 billion figure, is to be reduced by $47 million from the first Gramm-Rudman cut. We are not looking for what someone said our cake and eat it too. What we are looking for is a possible backup program or complementary program in I-Match that is alleged to be a benefit to the budget deficit picture and at the same time taking it into the private sector which the administration strongly approves of.

Senator HEINZ. Let's be clear on what the administration's approach, the I-Match approach, does. Under questioning, Mr. Draper admitted that it does the following: It does exactly what Exim does. It has exactly the same cost to the economy because of the guarantee issued by Exim to the banks. In effect, the only difference between going to private banks for the funding and going to the Federal Financing Bank, which is another alternative, to sell Exim paper is that going to private banks costs more. It's substituting somebody else's cost of borrowing for Treasury's cost and, therefore, the cost of lending to Exim or to the exporter, in effect, is higher.

If I-Match is a relatively costly way of taking the operations of the Eximbank and hiding them from public view, are there better alternatives of taking it off budget and hiding it from public view that don't cost nearly as much money? All the money in terms of the I-Match interest rate subsidy is going to be charged against the capital and reserves of the Bank. Within a few years there won't be any reserves and maybe any capital for it to be charged against, if Senator Proxmire has his way with the GAO. Then you will have an interest rate subsidy being appropriated each year under Gramm-Rudman and I don't know how long Congress would want to appropriate interest rate subsidies to banks. Banks are not the absolutely most beloved institutions. They tend to foreclose when people get in trouble and that's thought to be unfair.

Ms. MAZON. If I had my druthers, Mr. Chairman, as you well know, I wouldn't be discussing I-Match II. It is not my preference of the programs which the Bank may have in its charter. I think

the Direct Credit Program has worked remarkably well for almost all of the Bank's history. It's just a matter of the budget crunch and what you people are faced with that it looks as though this experimental program could be run as a complement to a reduced Direct Credit Program.

I guess we're looking for a security blanket in a way for the exporters but, on the other hand, we're just facing the facts that you're going to have to reduce spending and this looks like a spending cut.

Senator HEINZ. There's going to be a lot of pressure on the Budget Committee and on the Appropriations Subcommittee on Foreign Operations to find money for additional foreign aid programs, commitments to the World Bank and the like. What is highly likely to happen, if we don't develop an alternative consensus, is that the direct credit authority of the Bank, while it will not be repealed, will be scaled down to almost nothing; because that's the only way that all the other things that the Reagan administration wants can be paid for.

In the name of false economy, spending on other programs in the jurisdiction of the Foreign Operations Subcommittee of Appropriations will be increased. Exim will go off budget in the most expensive possible way and you will have only the I-Match Program plus nominal direct lending authority. Direct lending will still be there but there won't be any funds for it. That is what will happen.

BETTER ALTERNATIVE THAN I-MATCH?

The question I pose, therefore, is, since I-Match ends up driving the Eximbank out of capital and reserves at some point, can a better alternative be found than signing on to a program which, under the scenario I've just outlined, tends to have the Bank disappear in 4 or 5 years?

Ms. MAZON. We anticipate that in a couple of years it will no longer be as deep a secret or out of the reach of the Congress, the I-Match Program and the results of it, and therefore, retaining the Direct Credit Program in the mandate even though it's at a quiet level or no level at all if that's what we come to—keeping the ability for the Bank to exercise a direct credit authority may come back into your focus in 2 or 3 years when the I-Match proves to be a costly endeavor and an outright subsidy where it will hang out every time you go back to the Hill. It will be an outright subsidy.

Senator HEINZ. So you're saying go along with I-Match now. We're not quite sure whether it will work. We recognize that we may say we're going to go along with it as a trial balloon, but we do understand that it is going to be the program. The hope is that in 2 or 3 years maybe we could convince people to do something different from what we are doing now and different from the I-Match Program. Is that what you're saying?

Ms. MAZON. No; we hope that it is not the only program. That's why we're fighting for the retention of the Direct Credit Program even at a low rate.

Senator HEINZ. Suppose you are dead wrong?

Ms. MAZON. And it does work?

Senator HEINZ. No. [Laughter.]

No. That I-Match is the ball game in fiscal 1987, and that the Appropriations Committee and the Budget Committee, in looking to avoid Gramm-Rudman, see more budget demand than can be accommodated. Therefore, these committees look at the $1.7 billion in direct-credit authority or $1.4 or $1.2 billion or whatever you're thinking of it as being next year, and say, well, we just can't avoid the Gramm-Rudman sequester without zeroing that out. And you end up with only I-Match, plus some alleged direct loan authority that won't be meaningful because there won't be any money appropriated to it.

Now are you prepared to live with that? Because that's what's going to happen, unless we find another alternative.

Ms. HARSANYI. Senator, I think that you have very aptly portrayed our worst fears. I think that you're absolutely right, that I-Match is a costly way of taking the Direct Loan Program off budget and our preference, of course, would be to maintain the Direct Loan Program.

You asked if there would be a less costly way to take it off budget.

Senator HEINZ. I can think of four.

Ms. HARSANYI. I think to be very honest with you, we have been so busy peddling uphill to make sure that either the Direct Program is competitive or I-Match, if that's what we end up with, is workable, that we haven't adequately studied other less costly ways of doing it. Maybe what we are doing now is buying time so that we can do that kind of study.

Senator HEINZ. My time has expired, but you have less time than I do. There is not a lot of time, particularly if you reflect on the scenario which I think frankly is nearly inevitable if we endorse I-Match.

Senator Proxmire.

Senator PROXMIRE. Dr. Harsanyi, you say on page 1 of your testimony that you believe that the time is ripe for a clear ringing statement of support for the Bank from the Congress.

Since our competitors must be aware of the Bank's deteriorating capital position, don't you agree that we must cure that problem before the Bank can really be seen as a credible institution in the long run, no matter what kind of ringing rhetoric we make in the Congress?

Ms. HARSANYI. Yes, I would agree with that.

Senator PROXMIRE. You agree with that?

Ms. HARSANYI. Yes.

Senator PROXMIRE. Mr. Velden, you say on pages 2 and 3 of your testimony that ECAT is concerned about the administration's proposal to fund its I-match Program out of its reserves, particularly since GAO suggests these reserves may soon be exhausted if they're not already.

FUNDING FOR I-MATCH

How would you propose that the Bank fund its loan program, either I-Match or the Direct Loan Program, in view of its own declining resources?

Mr. VELDEN. I think it has to be funded through appropriations as we've been doing in the past years. We can't continue to reduce the reserves and have a viable Bank.

Senator PROXMIRE. Well, I agree with that. Then, would you favor a pay-as-you-go approach on that?

Mr. VELDEN. Yes, sir.

Senator PROXMIRE. Ms. Mazon, you note on page 8 of your testimony that one advantage of the I-Match II Program is that it will be funded from the Eximbank's reserves and thus there would be no budget outlays.

Are you aware that the GAO believes the Bank's reserves are nearly exhausted and, if you are, do you have any proposals for funding the Bank's new program?

Ms. MAZON. I read the report this morning, sir—I read the testimony that is to be given and I now identify with their approach to this. I'm not quite sure I agree with them, but it is much too highly technical a paper for me to understand so quickly.

I would like to say that I think that Senator Heinz remark about the options is of great interest to us on how the Bank could continue operations other than through I-Match or a retention of the Direct Credit Program. If there are options, I think that this group, all of us—the four organizations present this morning—would like to study those options and perhaps change our strong position on the retention of the Direct Credit Program as a complement to I-Match or to just have the Direct Credit Program.

I think we have to be open minded in view of the present budgetary restraints and your opening comments, Senator Heinz, talked about the understanding of the budgetary measures and we seem all of us to not have concentrated on that area as well as we should.

Senator PROXMIRE. As you know, we're in the era of Gramm-Rudman. We're in the era of putting everything on the budget and not having the kind of exemptions we've had in the past. Would you object then to keeping this on budget if we treat everything else that way? Why should it be off budget?

Ms. MAZON. I don't dream that it will be off budget in my lifetime. I've been through the Bank's problems that——

Senator PROXMIRE. You're going to live a long time.

Ms. MAZON. Well, Senator, you know I was there before when we talked about the same situation and about taking the Bank off budget. We at one time did take it off budget in the Nixon years and it wasn't off budget too long until some very concentrated efforts were made to put it back into the budget. But at that time it was I think correctly off budget and I think the Bank could have continued to operate very effectively and profitably had it remained off budget. Part of its problems are due to the fact that it was put back into the budget.

Senator PROXMIRE. Mr. Williams, on page 2 of your statement you analogize the fortunes and misfortunes of the Eximbank with those of your employer, Caterpillar Tractor. You say:

> Like Caterpillar, the Bank suffered a loss in 1982, the first loss in its 48 years of its existence and that Caterpillar's recovery strategy of targeting resources, reducing costs, developing new products, and increasing its aggressiveness in pursuing potential worldwide markets restored its profitability in 1985.

As a general view, it seems that Caterpillar revitalized itself by both increasing its customer base and by decreasing its expenditures. The Eximbank, unlike Caterpillar, has not regained its profitability since its initial loss in 1982, but rather has continued losing money.

Yet you suggest the Bank increase its spending through the funding of both a Direct Loan Program and the I-Match proposal, how do you suggest the Bank regain its profitability by running two rather than one costly program?

Mr. WILLIAMS. A very good question, Senator. I guess our concern is, as has been mentioned here earlier, that the second program, the I-Match I or II, was not our primary choice. We prefer direct funding continuation, the simplest and most cost-effective approach. At the same time we recognize the problems facing Congress in respect to rationalizing program authorizations in light of budgetary constraints.

The position that we took in our comments, and which was presented here by others, was that if we are headed toward I-Match, then we would like to retain direct funding for a while as we launch into this other approach and test it out. Our presumption was that if I-Match II is workable, then direct funding authority would not be required. So, in effect there wouldn't ultimately be two programs but there would be backup authority if it was required.

EXIM USED ONLY ONE-SIXTH OF ITS $3.9 BILLION

Senator PROXMIRE. Dr. Harsanyi, why can't Exim use its direct loan money? In fiscal year 1985, the Eximbank had $3.9 billion in direct loan authority. How much did it use? Only $660 million. President Draper said that the reason is that exporters preferred private financing.

Given this record, why do we need a loan program at all, either I-Match or direct loans? It would appear that private sector financing is able to do the job in most cases.

Ms. HARSANYI. First of all, I don't think they can do the job in most cases. We are facing very stiff competition overseas and my best example would be to suggest that we are going to foreign countries at times to source there in order to be able to access their direct credit programs.

Senator PROXMIRE. How do you explain the fact that they had $3.9 billion and used only about one-sixth of that, only $660 million?

Ms. HARSANYI. I think it's a combination of things, probably some things as Chairman Draper has suggested, whether it's the strong dollar or the lack of markets, saturated markets in some cases, the debt crisis—a number of things. But I would submit that among those things also in the past has been the competitiveness of Eximbank and the difficulty that exporters have had to get access to the direct loans.

Senator PROXMIRE. Thank you very much.

Thank you, Mr. Chairman.

Senator HEINZ. We could retain the Direct Credit Program or an I-Match Program with it or something in between as a substitute

for direct credit. Maybe we have I-Match as a test program with a different kind of program that did continue direct credit operations but ended up being scored realistically rather than prejudicially as the present system does to the Bank. As I say, I can think of four, or five, or six different alternatives. One of them is just to take the Bank off budget and score the costs each year of whatever subsidy the Bank requires; that is, take the loans off budget, but record any costs to the taxpayers.

Irrespective of the options, you still have to address the issue of how much new loan authority is going to be needed for any program in fiscal 1987. What is needed in fiscal 1987? Let's assume for the sake of argument we're doing it your way. How much direct loan authority is needed for fiscal 1987? Does anybody want to answer that?

Ms. MAZON. Apparently the predictions were way off last year. I've been thinking since you've had some options in the back of your mind, Senator, if you have thought anything at all about the no year authority that the CEE proposes, the carryover? For example, $3.9 billion, if we don't use it this year and we certainly didn't this past year, couldn't that be carried over so that for 3 years possibly it could cover the requirements of the Bank? The reason why the Bank has not really been able to use it to some degree is that a number of projects that were scheduled to be brought into the Bank did not materialize or were held up for various and sundry reasons. It could be country conditions or it could be finances in other areas. But I think that one bears some thought and I still would be very interested in your other options, too.

Senator HEINZ. Let's just talk about the operational aspects of the Direct Loan and Financial Guarantee Programs. What changes are most critical to all of you in this regard? I think all of you have mentioned—just about all—the 2-percent fee. Now Mr. Draper said that the 2-percent fee is smaller than the fees other people impose; it's not a problem, he said.

Ms. HARSANYI. That was certainly one of the things mentioned in our testimony and I said that while we can't make a case for the fact that 2-percent upfront fee has caused us to lose any sales, it has been an irritant. Chairman Draper suggested that if it were an insurance risk fee that in fact the amount would go up, that it would be more than two percent. We would suggest that it should vary, that in some cases, depending on the risk, it might be lower than 2-percent; and in some cases, indeed, it may be higher.

We certainly do think that we'd like to see it eliminated and if that's not possible to amortize it.

Senator HEINZ. If it's not possible to eliminate it, you would like it risk related and amortize it over the period of the loan?

Ms. MAZON. That's right. I don't quite understand the thinking that because other countries do it we must. In other words, if you're going to copy, why not copy on our edge, make it less costly in many ways and spread it over the length of the loan like the other countries do?

Senator HEINZ. Mr. Williams.

Mr. WILLIAMS. We have long favored the elimination of the 2-percent fee, but assuming that some fee is required we would like to have the Exim use discretion in its application so that there's some

flexibility on a transaction by transaction basis considering the particular situation.

MEDIUM-TERM PROGRAM

Senator HEINZ. Now let's focus on the Medium-Term Program for a moment. We've gotten a lot of comment formally and informally about that. How effective is that program and most importantly, can the changes that are needed in that program, assuming some are needed, be made by Exim or is legislation necessary?

Mr. WILLIAMS. May I speak to that one?

Senator HEINZ. Mr. Williams.

Mr. WILLIAMS. It seems to me this is an operational opportunity—if we go to the I-Match to improve the flexibility within the Medium-Term Program. I-Match II, as we mentioned, includes an improved Medium-Term Program which is very critical to us. We also believe there are some things that could be done to cause the cost of that program to be brought down by taking advantage of interest rate swings. This and other improvements wouldn't necessarily require legislation but could be managed within the existing charter of Exim.

Senator HEINZ. Let me ask one general question of a somewhat different nature than anything we've been talking about so far. We've been looking at the more immediate kinds of issues: How we get through this budget year, Gramm-Rudman, whether we get the Medium-Term Program to work better, are we fully competitive. It does seem to me we might benefit from stepping back and thinking strategically about the future of being in business 5, 10, or 15 years from now.

What issues should Exim be thinking about now to ensure that 5 or more years from now our export credit programs are indeed meeting U.S. exporters' needs at that time? It would have been nice 5 years ago to have said as we were working hard to negotiate an OECD arrangement, as soon as we do this, mixed credits will become a problem. They were back then. They're just more of a problem now.

As of today, what do you think we will be worrying about and should we be planning for that in the 5-year horizon?

Mr. VELDEN. We support the recent movement into fighting the mixed credits and we think and hope that by aggressively fighting them we will change the opinions of some of the other governments and they will go away from these type programs. Of course, by doing that, that will reduce the outlays that Eximbank requires. So I think we should be very aggressive in the area of fighting mixed credits.

Senator HEINZ. What about the relative importance of risk protection as opposed to subsidized interest rates? Rosemary, I see you struggling with that one.

Ms. MAZON. I find that a very difficult question to answer right now. I just simply don't know enough about that factor.

Mr. WILLIAMS. With respect to risk assessment or risk assumption, we think that in many countries the Bank standard for reasonable assurance of payment effectively closes the door on some of our transactions. Caterpillar has a sales opportunity in Chile where

we cannot get the Eximbank to support us, yet the International Finance Corp. and the export finance facilities of several other countries would agree to the exposure. So our view is that Eximbank should move to a standard such as reasonable expectation of payment and not rely on the overly stringent standard of reasonable assurance as is presently followed.

Senator HEINZ. The purpose of the Eximbank is to assist in the extension of credit when the private market, for whatever reasons, won't. So the Bank is in the business of undertaking riskier activities, at least as other people perceive them. You're saying that you believe that the Bank has been excessively conservative.

Is there agreement on that point; and if so, what does anybody do about it? Is this something the Bank should address or should we address it in the charter and, if so, how?

Ms. MAZON. Our group, CEE, undertook this discussion and we've struggled with the same thing and our words would have been reasonable expectation of repayment, but it's a matter of semantics. You never know whether that's going to be translated as you must have the money—it's like a commercial bank, in order to borrow money you have to have the money to pay them back or they won't make the loan in the case of very conservative banks.

In this case also the Bank has taken risks. For example, in Brazil. It has helped a number of exporters and there's still some question about the repayment, but in the long run those loans will most likely be repaid due to the nature of the country and what's happening over there. But every one of these organizations has addressed this issue. The fact that it's not in our testimony is that we just could not come to agreement within our own organization whether to approach it at this time. We have tried our best to keep our requests of you to a minimum because we feel your time is too valuable to address the whole long-range picture and looking down the road at what the Bank should be doing in the report language and in the implementation language we feel we can come to answer the question you just asked about what they should be doing in addition to being kept in business.

Senator HEINZ. Dr. Harsanyi.

Ms. HARSANYI. I'd like to add something to that. I agree with that and on reflection I do think that as the world gets riskier certainly the issue of risk would become a more important one.

Senator HEINZ. Do you believe in the Kondratieff Wave?

Ms. HARSANYI. What is that?

KONDRATIEFF WAVE THEORY

Senator HEINZ. That is the theory of worldwide depression which is advanced by J. Forester at MIT and others, the Kondratieff Wave. It was written up on the editorial page of the Wall Street Journal a couple weeks ago, explaining that the world goes through boom and bust cycles principally driven by the larger and larger assumption of debt by public and private borrowers until there's a collapse.

Ms. MAZON. An academic theory.

Ms. HARSANYI. I don't think I'm ready for that.

Senator HEINZ. According to the theory, the world is definitely going to become riskier, and soon.

Ms. MAZON. I'd hate to call that academic theory when Dr. Harsanyi is sitting next to me.

Senator HEINZ. I can see it's widely accepted.

Ms. HARSANYI. It occurred to me also that your earlier question about what we want to look for in the future, what other areas besides mixed credits—I think the area of lines of credit that some governments are willing to extend to foreign governments and then almost negotiate projects or identify projects that a country would be willing to give to another country when the times comes. Having said that, I'm not sure what the U.S. response should be and whether the answer to that is a political response or it's through negotiations or it's a financial response. That remains to be seen, but I certainly think it's a problem to look out for.

Senator HEINZ. Mr. Williams, do you have a comment?

Mr. WILLIAMS. Yes. On the competitiveness mandate, we support a refinement in the mandate to emphasize that as a matter of standard practice the Bank's program should be available on the best terms allowable under the OECD guidelines. We believe such a mandate would help in policing official financing practices.

Senator HEINZ. Very well. Well, if there are no other questions, we want to thank you.

Senator PROXMIRE. I do have a request, not a question, because I know the time is very late and we have another witness. I would appreciate it if each member of the panel would in writing send to us, when you correct your remarks, your view of the bill I have introduced. Let me just describe it very briefly.

It would require the Bank to maintain a minimum level of capital stock and retained earnings in an amount not less than $2 billion. It authorizes Congress to appropriate the funds the Bank will need to comply with that requirement. It also obligates the Bank to estimate its loan losses and deduct that amount from retained earnings in accordance with generally accepted accounting principles.

Senator HEINZ. Thank you all very much. We appreciate your testimony.

[Response to Senator Proxmire's request for comments on S. 2053 follows:]

COMBUSTION ENGINEERING

Fruzsina M. Harsanyi
Director
International Government Affairs

February 20, 1986

Mr. Edward M. Malan
Senate Committee on Banking, Housing,
and Urban Affairs
Room SD 534, Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. Malan:

Enclosed is the corrected transcript of my testimony of February 7.

In addition, we were asked by Senator Proxmire to comment on S. 2053. Since the National Foreign Trade Council's Export Finance Committee has not had an opportunity to study it, these comments are preliminary. Senator Proxmire directed his question to me initially and the way he worded it, I could certainly agree with him at the hearing, i.e., the bank's deteriorating capital position will affect its credibility in the long run. While this may be true, I would first question whether the urgency of the situation is so great that it needs to be addressed this year in a very difficult budget climate. Second, I question the $2 billion figure. I do not know what calculations were made to arrive at that figure, but it seems to me that $2 billion should not be regarded as some magic threshold above which the credibility of the bank is sound and below which it is not.

While we appreciate the Senator's concern about the capitalization issue, we believe that the most important action Congress could take to effect Eximbank's credibility is to offer exporters an adequately funded--and accurately scored--credit program.

We will review S. 2053 with the NFTC Export Finance Committee and look forward to future discussions with him and his staff.

Sincerely,

Fruzsina Harsanyi

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February 20, 1986

Mr. Edward M. Malan
Senate Committee on Banking, Houseing,
and Urban Affairs
Room SD 534, Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. Malan:

Please find attached the corrected version of Miss Mazon's testimony.

In addition, we offer the following comments regarding S-2053, as requested by Senator Proxmire.

The objective of the Bill appears laudible but we are not sure the goal is attainable in this tight money environment - i.e. a new appropriation.

On a second matter, the application of generally accepted accounting principles leaves some question as to that applicability to the Bank. We attach a copy of Mr. Hess's letter contained in the 1984 Eximbank Annual Report which suggests a uniqueness to the Bank's operation.

Overall, we would like to register our interest in continuing the assessment of the Senator's effort in the context of the Bank's capitalization needs.

Sincerely,

Bruce B. Talley
Executive Director

Enclosures

Bruce B. Talley
Executive Director

Sandra W. Wobbe
Administrator

Co-Chairmen

Marvin J. Boedé
General President
United Association of
Plumbers & Pipefitters

Raph H. Chew
President, Chew International
Group

Douglas D. Danforth
Chairman and
Chief Executive Officer
Westinghouse Electric
Corporation

Robert A. Georgine
President, Building and
Construction Trades
Department, AFL-CIO

Bob Graham
Governor of Florida

Cordell W. Hull
Senior Vice President and
Director, Bechtel Group, Inc.

Rudy Perpich
Governor of Minnesota

Charles H. Pillard
President
International Brotherhood
of Electrical Workers

Walter Sieckman
Executive Vice President and
Chief Operating Officer
Pennsylvania Engineering
Corporation

J.C. Turner
General President, International
Union of Operating Engineers

Glenn E. Watts
President, Communications
Workers of America

imagery. These items represent millions of dollars in research and development costs that can not be recovered in U.S. sales alone.

We realize that U.S. efforts to counteract foreign mixed credit competition have only been partly successful. France, Japan, and West Germany continue to siphon off attractive American export opportunities around the world through providing financial concessions.

Resources to combat foreign interest subsidies are scarce. Nonetheless, we are gratified that Eximbank saw the Brazilian market situation as one that required aggressive action. We hope that the Bank will continue to show a willingness to battle mixed credits around the world -- assuming it is given the necessary resources.

Without an institution like Eximbank that has U.S. exports as its primary mission and that continues to adhere to the "competitiveness" mandate of its Charter, we will lose substantial foreign sales and markets. We understand the hard choices Congress must make in the present budget situation, but we also see a tremendous potential for exporting the products of our medical technology if we can discourage foreign competitors from tipping the scales with government subsidies.

Medical technology offers unique opportunity for export growth because it is among the last areas in which the U.S. enjoys world leadership. Our competitors realize this because otherwise they would not perceive a need to offer major financing concessions. They do so because on even terms they know we would beat them every time.

CONCLUSION

Mr. Chairman, we urge the Congress to renew the authorities of the Eximbank for a period of six years, maintain Eximbank's mandate for

direct credits at the current authorized level of $1.1 billion, direct a trial run for the interest-matching program, and, within the limits prescribed by the deficit situation, continue to encourage its active participation in fighting off foreign mixed credits. Only if the playing field on financing is even can Johnson & Johnson and other ECAT companies maintain the strong presence in world markets of which they are truly capable.

Thank you for your courtesy in having me here.

Management Report on Financial Statements and Internal Accounting Controls

Eximbank's management is responsible for the integrity of the financial data included in the Bank's Annual Report whether audited or unaudited. For the past two years, the Comptroller General has stated his opinion that because the Bank has not established a specific loan loss reserve, the Bank's financial statements do not present fairly the financial position of the Bank. For the following reasons, however, the Board of Directors of the Bank has concluded that the establishment of a specific reserve is neither necessary nor appropriate.

First, since its inception in 1934, Eximbank has consistently followed a practice of writing off loans only when, in the opinion of the Board, they were determined to be uncollectable. The major share of its portfolio is made up of sovereign risk loans. The Bank is extremely cautious about writing off loans to government obligors and guarantors because we believe these sovereign risk loans will be repaid. Neither historical performance nor a general analysis of its portfolio provides a basis upon which Eximbank could establish a specific loan loss reserve. Instead, the Bank has always considered its entire retained earnings to be a "Reserve for Contingencies and Defaults." This position was accepted by the Comptroller General until FY 1983.

Second, significant adverse foreign policy implications could result from the establishment of a loan loss reserve. In order to arrive at a specific loan loss reserve, Eximbank would have to make determinations that certain countries are not likely to repay their indebtedness to the Bank. Not only would United States bilateral relations be damaged, but the ability to collect debt owed to United States Government institutions could be seriously impaired.

Third, the establishment of a loan loss reserve would not be a useful management tool nor would it add to disclosure since full disclosure is already provided in Eximbank's financial statements where rescheduled and non-performing loans are specified.

This year, for the first time, the Comptroller General has suggested that Eximbank's long-standing practice of accounting for claims on a cash basis should be changed to the accrual basis. This issue was not raised with the Bank until mid-March 1985, almost six months after the close of FY 1984. At that time it was not clear to the Comptroller General that changing to an accrual basis would significantly change the FY 1984 reported financial results.

Since additional costs would be incurred to develop yearly accrual figures for claim payments, and since it is not clear that the accrual basis would more accurately reflect Eximbank's financial results, the Bank decided not to modify its accounting treatment of this item for FY 1984. The Bank will study the feasibility and desirability of changing in the future to an accrual basis for claim payments.

Eximbank maintains a system of internal accounting controls designed to provide reasonable assurance at reasonable cost that assets are safeguarded, that transactions are processed and properly recorded in accordance with management's authorization, and that the accounting records are reliable for preparing financial statements and other financial information.

Accordingly, in our opinion, Eximbank's policies and procedures, including its system of internal accounting control, provide reasonable assurance that the financial statements of the Bank are prepared in accordance with generally accepted accounting principles consistently applied in all material respects. We believe that the statements reflect fairly the results of operations and changes in the financial position of Eximbank.

James K. Hess
Treasurer-Controller

Senator HEINZ. Our last witness is Mr. Wolf of the General Accounting Office. Mr. Wolf, welcome. Please proceed.

STATEMENT OF FREDERICK D. WOLF, DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, GENERAL ACCOUNTING OFFICE

Mr. WOLF. Mr. Chairman and members of the subcommittee, I am pleased to be here this morning to testify on the financial condition and reporting practices of the Export-Import Bank. We have a somewhat longer statement which I would like to submit for the record and just briefly summarize some of the salient points.

Senator HEINZ. Without objection, so ordered.

[The complete prepared statement follows:]

Senator HEINZ. Thank you very much. I have a few questions for you.

The first one is that the U.S. Government, the Treasury Department in particular, has a policy of holding foreign countries accountable for their debts and has never declared a sovereign obligor to be in default of its obligations to the U.S. Treasury.

Why should the Eximbank take the steps that you're calling for, without the Treasury doing so with its nonperforming sovereign loans?

Mr. WOLF. Well, first of all, the Treasury in conjunction with the Comptroller of the Currency and others have established a policy that says certain sovereign loans are in fact subject to question as to their ultimate collectibility and have identified a number of countries where they do require that banking institutions and other organizations who report to the public reflect a loan loss reserve for them.

Senator HEINZ. Yes, but that has to do, as I understand it, with what they believe private market institutions that are not Government institutions, banks that raise capital in the capital markets, need to do in the way of disclosure and proper accounting practices for private sector banks.

Exim is an agency of the Government. The Treasury doesn't do what you're saying the Bank should do because it is the Government and has certain other responsibilities, I assume. Exim is an agency of the Government. Why should it do something that another agency of the Government doesn't intend to do, even though it tells private sector people to do it?

Mr. WOLF. First of all, when we say establish a reserve, we're not saying write it off and don't try to collect it. What we're saying is, when you make an analysis of——

Senator HEINZ. I know what you're saying, but the Treasury Department doesn't do that for money that it lends.

Mr. WOLF. If we were dealing with Treasury and their financial position, we would say the same thing.

Senator HEINZ. You're saying they should, but why pick on Exim? Why not pick on both?

Mr. WOLF. Currently we don't do an audit of Treasury. If we did, we would be saying the same thing.

EXIM'S PURPOSE IS TO TAKE RISKS THAT PRIVATE LENDERS WON'T

Senator HEINZ. Thank you. The intent of Congress on Exim, I think is clear. As we were saying earlier to the previous panel of witnesses, the Bank's purpose is to take risks that private lenders won't.

Doesn't your directive that Exim write off loans that are inherently riskier, penalize the Bank for doing what Congress has specifically directed it to do and ultimately discourage the Eximbank from providing the kind of export support for which it was created?

Mr. WOLF. No, I don't think it should. I think what we're saying is, that's fine if that's Congress' decision as to the policy the Bank should follow. What we want to do is ensure that when the Bank reflects its costs that it acknowledge that credit risk is also a cost

that's incurred. So that we don't decide something based on lack of data.

Senator HEINZ. But doesn't that ultimately operate against the Bank because people will compare it to private institutions that don't take risks and that, in fact, leave to the Bank those kinds of credit risks that the Bank was established to service? Doesn't that invite odious comparisons, that to untrained observers, will operate to the prejudice of the Bank?

Mr. WOLF. I'm not sure that the comparison that one should make is to private banks particularly.

Senator HEINZ. I'm sure that we shouldn't. Nonetheless, since the Treasury Department is going to continue to do what they do, the only entities to compare this Bank to is private sector institutions and the irony, of course, is that this institution is taking risks the private sector won't. That's why we're here.

Mr. WOLF. That's why it's established and all we're saying is, Congress, when you establish it or reauthorize it or whatever, recognize that these loan programs do have a credit cost as well as just an interest rate differential.

Senator HEINZ. I assume you're not suggesting that Exim's entire loan portfolio be treated as grants and written off?

Mr. WOLF. No.

TREATMENT OF EXIM IN THE BUDGET

Senator HEINZ. Yet, isn't that really the current treatment of Exim in the budget which requires that Exim loans be treated as expenditures or grants?

Mr. WOLF. The way that the budget presentation is made, it treats a loan as an outflow of funds from the Federal Government and we don't account in the budget process at all for the fact that we have assets which ultimately we should collect.

Senator HEINZ. So I'm right. The way we account for the Bank right now is that we make a loan and we write the entire thing off.

Mr. WOLF. If you only look at the budgetary process.

Senator HEINZ. That's what everybody looks at, isn't it?

Mr. WOLF. Yes, and that is——

Senator HEINZ. They only look at the budgetary process. That's 110 percent of what we're doing this year.

Mr. WOLF. If you only look at the budget, that is in fact what the budget says because if you have a loan——

Senator HEINZ. Just taking that point, isn't the current budget treatment a greater distortion of Exim's operations than the Bank's decision not to write off those loans?

Mr. WOLF. I'm not sure I would say it's a greater distortion. It's just a different way of looking at the entire Federal Government and, yes, there are problems with it.

Senator HEINZ. I said if you only look at the budget—and that is what most people look at—isn't the budgetary treatment of the Bank as it now exists a far greater distortion than what would happen if the Bank, in fact, decided to write off loans and report them as you describe?

Mr. WOLF. I want to be careful in how I answer that, but in fact——

Senator HEINZ. I'm just saying that this is true if you look at the budget numbers. I understand you're seeking an additional piece of information that doesn't necessarily impact on the budget process and I'm not trying to trap you into saying that you're against what you say you're for.

Mr. WOLF. No, I don't mean it that way either. What you're raising as an issue about the budget and the treatment is in fact a very valid criticism of the budget treatment not only of Exim but a number of similar loaning programs, no question. In fact, we are on record as saying that in some fairly far-reaching reports that talk about the entire problems of the budget process.

Senator HEINZ. Now you want Exim to classify and write off loans. At the same time, the administration is calling for Exim to make subsidy payments to private lenders under I-Match and charge them also against the Bank's reserves and capital.

By doing that all at once, aren't we going to put a terrible financial strain on the Bank exactly at a time when our trade deficit is at a record level?

Mr. WOLF. By doing that we will accurately reflect the fact that there is an added strain on the Bank if you go with an I-Match Program.

Senator HEINZ. So what you're saying is, yes, it would put a financial strain on the Bank, but that strain is there already?

Mr. WOLF. That's right. All we're doing is recognizing a fact.

Senator HEINZ. However, the way Congress keeps the books, which you've said is unrealistic——

Mr. WOLF. I'm not sure I follow——

Senator HEINZ. You've just said that the way in which we in Congress keep the budget books is unrealistic.

Mr. WOLF. Yes.

TREAT EVERY LOAN AS A GRANT

Senator HEINZ. Because we treat every loan as a grant.

Mr. WOLF. Yes.

Senator HEINZ. And what I'm saying is: first, you're treating all the loans as grants; second, you have an I-Match Program and there are additional costs and subsidy payments that get charged against the Bank's reserves and capital; and third, you ask Exim to do what no other agency of the Government does. The State Department doesn't do it, the Treasury Department doesn't do it, none of the international agencies to whom we lend money and who make soft loans to lots of other people get scored as you're suggesting. We lend money to the International Monetary Fund, right? We're going to get all that back some day too, right?

Mr. WOLF. You said we would. I'm not sure that that's the case.

Senator HEINZ. In any event, we end up here doing the reserving you just described. If you add those three things up, doesn't that rather make the Bank look like it's just the worst thing in the world?

Mr. WOLF. No, because in fact you don't add those. You don't add the budgetary and the financial implications of the cost. If we did it right, what we would do is we would reflect in the budget only

the cost of ultimate uncollectibility and we would not treat them as grants.

Senator HEINZ. But let's just see what we would do in fiscal 1987. Let's assume that we said to you, "Gee, that makes sense. We're going to do it." And let's assume we decided to keep treating the Direct Credit Program the way it's now treated and we did what the exporters want, which is to have some I-Match to try that out and see how it goes. What we would have is a $1.7 billion outlay attributed to the Bank which isn't a real outlay. It's a budget outlay but it's not a real expenditure because it creates an asset.

Mr. WOLF. I-Match is a real expense. Loans create an asset.

Senator HEINZ. Then you would say, well, you've got to also deduct the money being lost on these loans, since we don't think they're collectible. We may be right or we may be wrong, but that's a hit against the Federal budget. You write something off in the Exim accounts and that's a charge, that's a loss——

Mr. WOLF. No, that doesn't——

Senator HEINZ. Why is that?

Mr. WOLF. The way the budget is kept, we ignore everything that happens after you send that money out. So none of what we're talking about is a budgetary accounting.

Senator HEINZ. So you're saying you just want these numbers but we should ignore them for budgetary purposes?

Mr. WOLF. No; you use those in the debate and in the discussion about the Bank when you look at the Bank, the way that the budget is kept by Congress and the executive branch doesn't impact on that directly.

Senator HEINZ. I don't understand why you want numbers that shouldn't be a part of the budget.

Mr. WOLF. We would like to see the budget done right as well. The budget isn't done right.

Senator HEINZ. But you haven't proposed that.

Mr. WOLF. Not in connection with Eximbank, but we have in connection with the total budget.

Senator HEINZ. So you're saying that if we're going to do what you urge, we ought to make some other major changes in the budget if it's going to be done right?

Mr. WOLF. You don't have to make those changes in the budget.

Senator HEINZ. But you should?

Mr. WOLF. Yes.

Senator HEINZ. Thank you.

Senator PROXMIRE. Mr. Wolf, all loans made by the Federal Government are treated as expenditures?

Mr. WOLF. That's right.

Senator PROXMIRE. As far as the budget is concerned and the deficit is concerned, aren't all loan repayments—and most of those loans are repaid—treated as income? So that on both sides of the ledger we differ from the private sector. On the assumption that the Government is loaning and collecting about as much year after year it doesn't make that much difference, only net lending shows up in the budget. Is that right?

Mr. WOLF. Correct as to the accounting.

Senator PROXMIRE. And we should show net lending in the budget in the judgment of this Senator. If we're going to change

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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STATEMENT OF

FREDERICK D. WOLF, DIRECTOR

ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE

AND MONETARY POLICY

OF THE

SENATE COMMITTEE ON BANKING, HOUSING

AND URBAN AFFAIRS

ON THE

FINANCIAL CONDITION OF THE EXPORT-IMPORT BANK

OF THE UNITED STATES

Mr. Chairman and Members of the Subcommittee:

I want to thank you for the opportunity to offer testimony today concerning the financial condition and reporting practices of the Export-Import Bank of the United States (the Bank). GAO annually audits the Bank's financial statements, and we are currently engaged in an audit of the Bank's fiscal year 1985 financial statements. Today, I will discuss the results of our prior audits and our preliminary analysis of the Bank's 1985 financial data.

As early as 1975, we expressed concern that the Bank's retained earnings were being eroded as a result of the growing amount of loan delinquencies. In April 1983, we went on record before the House Subcommittee on International Trade, Investment and Monetary Policy expressing our concerns about loan delinquencies and the negative interest rate spread. Since fiscal year 1983, we have reported that the Bank's financial statements present a misleading picture of its true financial condition. In our opinion, the Bank's statements do not reflect the losses that are likely to occur due to the probable uncollectibility of a significant portion of the Bank's loans that are owed or guaranteed by foreign governments.

The uncollectibility of loans has taken on increased importance considering that the Bank has been operating at a loss since fiscal year 1982 and will again report a loss for fiscal year 1985. The Bank's retained earnings have eroded due to the negative interest rate spread and, if loan losses were also properly reported, the government's equity would be substantially reduced. The principle of recognizing loan losses in accordance with accepted accounting practices is well established for private financial institutions and should apply equally to government corporations such as the Export-Import Bank. Unfortunately, the consequence of not maintaining adequate loan loss reserves is also well established, as evidenced by the problems of savings and loan institutions, farm credit banks, and the Maritime Administration's shipbuilding fund (MARAD).

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THE BANK'S FINANCIAL POSITION

The Bank reported net losses in its fiscal years' 1982, 1983, and 1984 financial statements of $160, $247, and $343 million, respectively. In fiscal year 1985, the Bank will record a larger net operating loss, estimated to be about $378 million.

The yearly operating losses reported by the Bank result primarily from three sources: (1) the amount by which interest expense exceeds interest revenue, (2) the amount by which the cost of insurance and guarantee claims exceeds insurance premiums and guarantee fees, and (3) administrative expenses. These operating losses have reduced the Bank's retained earnings from $2.0 billion at September 30, 1982, to $1.4 billion at September 30, 1984. By far, the largest source of losses reported by the Bank has been the negative interest rate differential. It is expected that the fiscal year 1985 loss will further reduce the Bank's retained earnings to about $1.1 billion.

This trend of increasingly larger reported losses is only part of the story. The Bank's accounting practices, which do not recognize loan losses, have resulted in retained earnings which are artificially high. The following assessment of delinquent and rescheduled loans, and insurance and guarantee claims that are considered by the Bank as loans, leads to the conclusion that the value of the Bank's loan portfolio is overstated.

First, delinquent loans at September 30, 1982, were reported at $1.4 billion, or 8.3 percent of total loans receivable. Preliminary data as of September 30, 1985, show delinquent loans will be $2.8 billion, or 16.3 percent of total loans receivable.

Second, the total amount of loans receivable which had delinquent installments prior to a rescheduling has increased from $1.2 billion at September 30, 1982, to $3.4 billion at September 30, 1985. This represents an increase from 7 to 20 percent of total loans receivable. Reschedulings also distort the financial picture in another way since previously recorded but unpaid interest is consolidated into the current debt. Under current Bank accounting practices, this amount is assumed to be fully collectible. The Bank then also records interest on the total amount rescheduled. At September 30, 1984, total interest added to loan principal balances and included in the Bank's retained earnings was $267.6 million, up from $125.8 million at September 30, 1982.

The Bank also has recorded as income interest that has become delinquent. The Bank assumes the delinquent interest will be collected and does not provide for any allowance for loss. That delinquent interest at September 30, 1984, was $278.1 million, up from $149.0 as of September 30, 1982.

Finally, the Bank operates guarantee and insurance programs. Under these programs, when a borrower defaults on an insured loan and the Bank is obligated to pay a claim, the Bank often treats the claim payment as a loan receivable. The net loans purchased, which are included in loans receivable, more than tripled from $288.5 million in 1982, to $984.2 million in 1985.

We consider loans that are currently delinquent, under reschedulings, or recorded as loan purchases to be "problem" debt because they exhibit characteristics that lead to delinquency and ultimate uncollectibility. The total problem debt, as of September 30, 1982, was $2.1 billion, or 12.7 percent of total loans; by 1984, that problem debt had more than doubled to $4.7 billion, or 29.3 percent of total loans. These amounts will again increase for fiscal year 1985.

Our attached analysis of the Bank's financial condition indicates that the amount of problem loans is increasing while the Bank's retained earnings is dwindling. At September 30, 1982, problem loans were roughly equal to the Bank's retained earnings. However, by September 30, 1984, problem loans, as a percent of the Bank's retained earnings, had risen to 322 percent. Preliminary estimates indicate problem loans will exceed 400 percent of the Bank's retained earnings as of September 30, 1985.

It is important for me to point out that we are not criticizing the Bank's rescheduling practices; these are policy decisions between the Congress and the Bank. We are concerned, however, that the results of these policies in the financial statements are not appropriately accounted for and fully disclosed.

Fair presentation of loans receivables requires a recognition in the accounts of the diminished value of loans through a charge against current year's income and a corresponding increase in an allowance for loan losses. The Bank has not recognized that its loans are impaired--even when the foreign governments repudiate the debts. The result, in our opinion, is a loan balance which is not fully collectible and, accordingly, is overstated.

The Bank reported retained earnings of $1.4 billion as of September 30, 1984. If an allowance for estimated loan losses had been provided, we estimate the Bank's retained earnings would decrease by $1.0 to $1.5 billion. This would result in a retained earnings of between $400 million or a deficit of $100 million, as of September 30, 1984. Admittedly, our approach involves judgment, but determining an allowance for losses, a common practice of financial institutions, is rarely subject to precise measurement.

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In summary, annual operating losses reported by the Bank since 1982 have eroded the government's equity, which was $2.0 billion in 1982, to about $1.1 billion in 1985. But these losses do not reflect the full cost of the Bank's operations because the Bank does not recognize the losses inherent in problem loans. By not recognizing the loan losses, the Bank's financial statements overstate annual income (or understate annual losses) and, on a cumulative basis, substantially overstate the government's equity position. The reason the Bank's financial condition should be presented in accordance with accepted accounted practices is to more accurately reflect the cost of its operations.

One significant result of not recognizing loan losses is the potential impact on congressional oversight. As shown on the statements, the Bank's financial position does not appear as severe as it is in reality, and the Congress may be led to make policy decisions that it would not otherwise make were the Bank's true financial condition fairly presented.

ATTACHMENT

ATTACHMENT

GAO ANALYSIS OF
THE FINANCIAL CONDITION OF THE
EXPORT-IMPORT BANK OF THE UNITED STATES
(ALL AMOUNTS IN MILLIONS)

		(4) (UNAUDITED) FY 85	FY 84	FY 83	FY 82
LOANS RECEIVABLE		$16,860	$17,504	$16,863	$16,565
PROBLEM LOANS	(1)				
DELINQUENT LOANS		$2,753	$2,707	$1,904	$1,377
% OF TOTAL LOANS		16.3%	15.5%	11.3%	8.3%
RESCHEDULINGS		$3,370	$1,546	$1,194	$1,178
% OF TOTAL LOANS		20.0%	8.8%	7.1%	7.1%
LOANS PURCHASED		$984	$757	$397	$289
% OF TOTAL LOANS		5.8%	4.3%	2.3%	1.7%
TOTAL PROBLEM LOANS	(2)	(5)	$4,663	$2,654	$2,098
GROWTH (FY82 BASE)		(5)	222%	126%	100%
REVENUES:					
INTEREST REVENUE		$1,478	$1,458	$1,342	$1,272
FEES, PREMIUMS & MISC		$85	$99	$82	$124
EXPENSES:					
INTEREST EXPENSE		$1,828	$1,746	$1,624	$1,479
NET LOAN WRITE-OFFS	(3)	$5	($20)	$5	$32
NET CLAIMS PAID	(3)	$78	$139	$14	$25
ADMIN AND OTHER		$30	$35	$27	$20
NET LOSS		($378)	($343)	($247)	($160)
CAPITAL		$1,000	$1,000	$1,000	$1,000
RETAINED EARNINGS		$1,072	$1,450	$1,792	$2,040
CAPITAL AND RETAINED EARNINGS		$2,072	$2,450	$2,792	$3,040
UNREALIZED INTEREST INCOME					
RESCHEDULED		$394	$268	$199	$126
DELINQUENT		$315	$278	$186	$149
CAPITAL AND REALIZED EARNINGS		$1,363	$1,904	$2,407	$2,765
TOTAL PROBLEM LOANS		(5)	$4,663	$2,654	$2,098
AS A % OF RETAINED EARNINGS		(5)	322%	148%	103%
AS A % OF CAP & RETAINED EARN		(5)	190%	95%	69%
AS A % OF CAP & REALIZED EARN		(5)	245%	110%	76%

NOTES:
1- LOANS THAT EXHIBIT CHARACTERISTICS THAT LEAD TO DELINQUENCY AND ULTIMATE UNCOLLECTIBILITY
2- EXCLUDING DOUBLE-COUNTING AMONG CATEGORIES
3- INCLUDES "LAKER AIRWAYS" LOSS OF $50M IN FY82 AND $35M GAIN IN FY84
4- PRELIMINARY FY85 DATA; UNAUDITED
5- AMOUNT AND PERCENTS CURRENTLY UNAVAILABLE; WILL INCREASE OVER FY84

our entire system, I suppose you could also analogize our accounting system to the private sector with respect acquiring all assets, not only loans but also aircraft carriers, fighter planes, and Bonneville power, and so forth.

Now if we follow that policy we really get into trouble. Thus far, in spite of the fact that Wayne Morse and John Heinz and others have called—John Heinz this morning—I hadn't realized he was a capital budgeteer—have called for this kind of policy, it's never gotten anywhere; and as long as it doesn't get anywhere, it seems to me to make an exception for the Export-Import Bank would not be sound and it would be really deceptive. At least, that kind of exception would confuse this Senator and I think it would confuse Members of Congress and confuse the general public.

Senator HEINZ. Are you talking about the administration proposal?

Senator PROXMIRE. I'm talking about the notion of handling loans by the Federal Government in the Export-Import Bank the way they're handled in the private sector, but not applying that elsewhere for other asset acquisitions.

THREE KINDS OF PROBLEM LOANS

Well, let me ask you, Mr. Wolf, in discussing the Bank's financial condition you identified three kinds of problem loans—delinquent loans, rescheduled debt, and loans arising from payment of insurance and guaranteed claims.

Can you describe for the committee the relative significance of these items and whether the Bank is properly accounting for them and what level of loan loss reserves the Bank should have in light of it's exposure?

Mr. WOLF. Delinquent loans amount to about 16 percent of total loans. Rescheduled loans amount to another 20 percent. Now there's a little bit of overlap in there because some of the rescheduled are also now again delinquent. The third piece you have are these purchased loans where you've taken over a claim or a guarantee. That's about $1 billion.

If you take all of those together at the end of 1984, which is the last time that we have real good numbers, it's about 27 percent of Exim's total loan portfolio. So a quarter of the loan portfolio has those different items in it.

Senator PROXMIRE. How much is that in dollars?

Mr. WOLF. It's in excess of $4.5 billion at the end of 1984 and it's higher in 1985 but we don't have those numbers yet.

Senator PROXMIRE. In your judgment, does the Eximbank adhere to the financial reporting practices required by the bank regulators and followed by banks in the private sector?

Mr. WOLF. No.

Senator PROXMIRE. It does not. Why?

Mr. WOLF. The reason that they don't comply is because they don't reflect any cost of writing off loans which you know you're not going to collect; any, what I call credit costs or credit risk costs in their financial accounts.

Senator PROXMIRE. Do you think they should, in spite of the fact that the chairman has made such a good point on the difference

between the private sector and the Government in its treatment of loans as assets and so forth? Do you think they should include this?

Mr. WOLF. Yes, I think they should.

Senator PROXMIRE. You think that would not be discriminatory if we had them do so?

Mr. WOLF. No. Let me just emphasize, I wouldn't limit that to Eximbank. I think any Government corporation or other agency that's putting out financial statement portraying results of their operations ought to be reflecting in those statements the same kind of costs.

Senator PROXMIRE. It's hard for me to argue with that. I think you're right.

Mr. Wolf, it's been suggested by some witnesses here today that the Eximbank should not be kept as part of the unified budget but rather should be moved off budget to a credit budget. Could you explain to us the implications of such a move and state whether GAO would favor such a proposal? If the GAO does not favor it, could you explain why?

Mr. WOLF. First of all, we think that you ought to have a unified budget and that everything effectively should be in it.

Second, if you do that, we think that you ought to also deal with the issue of capital budgeting or reflecting assets better than we do right now. Calling all of these loans outflows of money sort of implys that once it's paid that's the end of it. That is not the most appropriate way.

So, yes, on a unified budget, but once you begin making changes, make a number of others as well.

Senator PROXMIRE. Now I think the GAO recommended allowance for loan losses seems to be a good one for requiring the Bank to keep honest books, but I can also understand the concerns expressed by Mr. Draper that we shouldn't send a signal to foreign debtors that loans are being written off. If such a loan loss allowance is created for the Bank, would there be a need for disclosing specific countries and amounts? Do accounting standards permit such a system to be implemented without specifically listing the loans being written off? There's a delicate political problem obviously involved here.

Mr. WOLF. There is a little bit of a political issue here. Our standards would not require and we would not suggest that the details of loan reserve calculations be included in the financial statements. So it wouldn't be a disclosure item in a financial statement.

At the same time, as I mentioned to the chairman, we do as a Government already take a posture that says that some countries are credit risks and in financial statements you should write down some of those loans.

Finally, writing down a loan or reserving against uncollectibility on loans is not the same as saying we're forgiving a debt.

Senator PROXMIRE. If the reserves are gone in the Eximbank and the loans go bad, who has to pay?

Mr. WOLF. If there are no reserves in the Bank and the loans go back, effectively it flows back to the U.S. Treasury through the Federal Financing Bank.

Senator PROXMIRE. So the taxpayer has to pay?

Mr. WOLF. That's right.

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Senator PROXMIRE. Mr. Wolf, I want to thank you very much for your testimony. I requested that the GAO testify and the chairman very graciously acquiesced and I'm very impressed. I think, as usual, the GAO has done an outstanding job and I think your responses have been most impressive.

Senator HEINZ. Senator Proxmire, I'd like to concur in that. Even though I think in our questions Senator Proxmire and I led you in slightly different directions into, although not inconsistent, different conclusions than one or the other of us might have had in mind, I think you have answered all our questions quite honestly and you've done some very good work and you've put the Eximbank in the proper context between the private sector and where it is located in the public sector and I have always found the GAO, Senator Proxmire, to do this kind of good work and I want to commend Senator Proxmire for having urged strongly that we include the GAO in our hearing today. It's been well worth it.

Thank you very much.

Senator PROXMIRE. Would you for the record give me a written response on your reaction on the bill I introduced I described earlier?

Mr. WOLF. Yes, sir.

Senator HEINZ. The hearing is adjourned.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

[Response to Senator Proxmires' request from Frederick Wolfe and answers from witnesses to written questions of Senators Heinz, Mattingly, Proxmire, and Sasser follow:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

MAR 18 1986

B-197710

The Honorable William Proxmire
United States Senate

Dear Senator Proxmire:

This is in response to your request during our February 7, 1986, testimony before the Senate Subcommittee on International Finance and Monetary Policy, Committee on Banking, Housing and Urban Affairs, that the U.S. General Accounting Office comment on S. 2053. The bill titled "Eximbank Capital Restoration Act of 1986" would add new sections 15 and 16 to the Export-Import Bank Act of 1945.

The requirements contained in proposed section 15 are identical to those contained in S. 2906, which you introduced in 1984 and we supported. Section 15 would require the Export-Import Bank of the United States (Bank) to maintain capital stock and retained earnings of at least $2 billion at all times, and authorize the Congress to appropriate amounts that would enable the Bank to satisfy its requirement. While we have no basis for commenting on the appropriateness of the $2 billion threshold, we support the legislative intent to enable the Congress "to maintain closer surveillance of the Bank's operations and assist it in regaining fiscal solvency." You may wish to consider repealing existing section 14 of the act, which would be unnecessary if S. 2053 were enacted.

In commenting on S. 2906, we suggested that the Bank be required to recognize that a portion of its loans is uncollectible. We are pleased that your current bill would add a section 16 to the act to require the Bank to establish an allowance for loan losses and deduct the amount of such allowance from revenues and assets in accordance with generally accepted accounting principles. Since 1975, we have expressed concern that problem loans (delinquencies, reschedulings, and guarantee and insurance defaults recorded as loans) were eroding the Bank's retained earnings, and we have reported to the Congress and the Bank (most recently, GAO/AFMD-85-61, May 29, 1985) the need for the Bank to recognize loan losses in its financial statements.

Capital Level Requirements

Section 621 of the Supplemental Appropriations Act, 1984 (Pub. L. No. 98-181, 97 Stat. 1261 (November 30, 1983)), amended the Export-Import Bank Act of 1945 by adding a section 14. The new section provides that after fiscal year 1983, the Bank's Board of Directors shall notify the Congress if the value of the Bank's total capital stock and retained earnings at the end of any fiscal quarter falls below 50 percent of their value as of the end of fiscal year 1983. Section 14 also provides that notification shall occur not later than 30 days after the end of the fiscal quarter involved and that the Congress shall take appropriate action.

The Bank reported that the value of its capital stock and retained earnings at the end of fiscal year 1983 was approximately $2.8 billion. Therefore, the effect of section 14 is to trigger the Bank's reporting requirement and the Congress' response when the Bank's capital stock and retained earnings fall below $1.4 billion. However, section 15 as would be added by section 2 of S. 2053, if enacted, would require the Bank to maintain capital stock and retained earnings at a level not less than $2 billion, and authorize appropriations to prevent the value from falling below that level. Thus, the Bank would be expected to take action to obtain the necessary appropriations to stay above the $2 billion threshold. This would appear to eliminate the need for section 14. Therefore, you may wish to include in your bill a provision repealing section 14.

Treatment of Costs From Uncollectible Loans

Section 16 of S. 2053 will enhance the Congress' ability to maintain close surveillance over the Bank's operations by requiring the Bank to recognize the cost of loan losses in determining its equity position. The Bank's accounting practices, which do not recognize loan losses, have resulted in a cumulative retained earnings balance which is artificially high. As you stated when introducing S. 2053, our May 29, 1985, report suggests the Bank's Reserve for Contingencies and Defaults (retained earnings) may already be depleted. In that report, we estimated that if the Bank recognized losses on problem loans, its retained earnings as of September 30, 1984, would have been decreased by $1.0 to $1.5 billion, eliminating substantially all of the $1.4 billion in retained earnings accumulated from the Bank's results of operations. As of September 30, 1984, problem loans totaled $4.7 billion, or about 27 percent of total loans. The problem loans more than doubled since 1982 and will again increase for fiscal year 1985. The principle of recognizing loan losses in accordance with accepted accounting practices is well established for private financial institutions and should apply equally to government corporations, such as the Export-Import Bank. The Bank should fairly present its financial condition by recognizing loan losses in its financial statements.

Thank you for the opportunity to comment on S. 2053.

Sincerely yours,

Frederick D. Wolf
Director

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM

WILLIAM H. DRAPER III

Senator Heinz: The FY87 Budget proposes that some credit programs sell off assets in order to raise revenue. Has Exim considered this approach and, if so, what were the Bank's conclusions?

Mr. Draper: The Bank has looked at the possibility of selling assets. At this time it does not appear to be advantageous to the Bank to do so, since most of the loans carry a below market interest rate and would have to be sold at a loss. The Bank will continue to monitor the possibility of making loan sales.

Senator Heinz: Private lenders continue to cite two unresolved problems in Exim's long-term I-MATCH program. First, what type of marketable obligation will Exim provide to these lenders at the time of initial loan disbursement? Second, how will Exim handle foreign witholding taxes to ensure that neither the borrowers nor the private lenders bear this cost?

Mr. Draper: At the time of the initial loan disbursement, the lending institution will have a promissory note from the borrower. This note will be fully guaranteed by Exim as to repayment of principal and interest. Since Exim is now willing to pay an interest make-up based on a floating rate during the disbursement period, many banks will be willing to hold the note until completion of disbursements.

Eximbank will not require the lender to bear any foreign witholding tax. As in the Bank's current loan program, any such tax will be for the account of the foreign borrower.

Senator Heinz: Exporters note that Exim's 2% credit fee is uncompetitive--particularly since other export credit agencies vary their fees according to the riskiness of the transaction, allow the exporter to build the fee into the contract price, and finance the fee over the life of the credit. How was the 2% fee arrived at and how does it compare to fees charged by other export credit agencies? If Exim must charge a credit fee, why doesn't the Bank handle its fee in the same way as do other export credit agencies?

Mr. Draper: Exim's 2% application fee is lower than the insurance fees charged by many of its competitors. All other export credit systems charge for risk coverage; Exim does not on its direct loans. As competitor insurance premiums vary according to buyer type (public/private) and/or country classification (best/worst markets), there may be instances where their fee is lower than Exim's uniform 2%, but rarely. The only real difference between Exim and its counterparts on the matter of long-term fees is that the competitors charge the exporter and allow the fee to be financed over the length of the credit (Exim allows exporters to pay for the borrower and allows it to be paid over the disbursement period, up to three years).

Senator Heinz: Please explain the strategy which Exim plans to employ in using the proposed $300 million "war chest" and how the expected usage of the $300 million differs from the current mixed credit strategy employed by Exim (in terms of types of cases supported, frequency of mixed credit offers, etc.)

Mr. Draper: In cooperation with the Treasury Department, Eximbank will use the proposed $300 million warchest to aggresively target those OECD member countries that are standing in the way of reaching a solution to the problem of the use of tied aid credits for commercial competitive purposes. This will be done by initiating mixed credits in selected markets of importance to these countries, or by out-bidding mixed credit offers initiating mixed credits. Eximbank is currently employing this strategy in anticipation of enactment of the proposed "warchest" legislation.

Senator Heinz: Please supply listings of the top 20 direct loan users, by year, from FY 1979 through FY 1985, showing the U.S. exporter's name, the amount of direct loan support received, and the export value related to that support.

Mr. Draper: Attached are lists of the top exporters utilizing Exim long-term direct credits in fiscal years 1979 through 1985. The top 20 are provided from FY 1982 on and the top 10 in the earlier three years.

TOP 20 EXIM USERS--1985
Direct Credits Only

COMPANY[1]	EXPORT VALUE ($ mil.)	CREDIT VALUE ($ mil.)	PERCENT OF CREDITS AUTHORIZED	
			Total (%)	Identified* (%)
WABCO (Dresser)	58.0	37.7	11.8	17.2
General Electric	45.4	24.0	7.5	11.0
Bell Helicopter	28.3	18.4	5.7	8.4
Cubic Western	25.5	19.6	6.1	9.0
Harnischfeger	24.0	15.6	4.9	7.1
Badger Company (Raytheon)	23.1	17.3	5.4	7.9
Atlas Powder Company	21.1	13.7	4.3	6.3
Caterpillar	20.0	13.3	4.2	6.1
Johnson & Johnson	16.1	13.7	4.3	6.3
Morrison-Knudsen	11.4	7.4	2.3	3.4
Goodyear	10.0	6.5	2.0	3.0
Varian	5.9	5.0	1.6	2.3
CRS Sirrine, Inc.	5.7	4.3	1.3	2.0
Koehring	4.1	3.1	1.0	1.4
Ortner Freight Cars[2]	3.9	2.5	0.8	1.1
Hewlett-Packard	2.2	1.8	0.5	0.8
Ingersoll-Rand	2.0	1.3	0.4	0.6
Cooper Industries	1.6	1.2	0.3	0.5
Beckman Instruments	1.6	1.4	0.4	0.6
PRC Engineering	1.5	1.3	0.4	0.5
TOTAL	311.4	209.1	65.3	95.6

1) Ranked according to export value.

2) Small business.

*It is not always possible to immediately identify the equipment suppliers under Exim's direct loans, as specific procurement decisions may not be made until some time after the loan is authorized. Thus, this column is based on only the "identifiable" exporters in each fiscal year.

TOP 20 EXIM USERS--1984
Direct Credits Only

COMPANY[1]	EXPORT VALUE ($ mil.)	CREDIT VALUE ($ mil.)	PERCENT OF CREDITS AUTHORIZED Total (%)	PERCENT OF CREDITS AUTHORIZED Identified* (%)
Boeing	523.8	334.3	30.3	35.2
McDonnell Douglas	339.2	122.8	10.9	12.9
General Electric	179.4	100.7	8.9	10.6
United Technologies	132.9	63.7	5.7	6.7
Lockheed	79.0	49.4	4.5	5.2
Bell Helicopter	69.2	51.8	4.6	5.5
Gulf Oil	48.2	36.2	3.2	3.8
Blaw Knox	47.0	35.3	3.1	3.7
Johnson & Towers	41.8	31.4	2.8	3.3
Cincinnati Milacron	24.8	21.4	1.9	2.3
Tippens Machinery Co.[2]	13.0	9.8	0.9	1.0
Texex (GM)	9.9	7.4	0.7	0.8
Santa Fe International	8.7	5.7	0.5	0.6
USS Engineers	8.0	6.0	0.5	0.6
Unit Rig	7.5	5.6	0.5	0.6
Giant Corp.	7.5	4.9	0.4	0.5
Caterpillar	6.5	4.8	0.4	0.5
Superior Cable	5.9	2.5	0.2	0.2
Dresser Industries	4.8	3.1	0.3	0.3
Otis Engineering	4.6	3.0	0.3	0.3
National Supply	4.6	3.0	0.3	0.3
Hewlett Packard	3.8	2.4	0.2	0.2
TOTAL	1,570.1	905.2	80.3	95.3

1) Ranked according to export value.

2) Small business.

*It is not always possible to immediately identify the equipment suppliers under Exim's direct loans, as specific procurement decisions may not be made until some time after the loan is authorized. Thus, this column is based on only the "identifiable" exporters in each fiscal year.

TOP 20 EXIM USERS--1983
Direct Credits Only

COMPANY[1]	EXPORT VALUE ($ mil.)	CREDIT VALUE ($ mil.)	PERCENT OF CREDITS AUTHORIZED Total (%)	PERCENT OF CREDITS AUTHORIZED Identified* (%)
McDonnell Douglas	323.0	88.6	12.8	13.6
United Technologies	309.1	180.4	26.1	27.8
Boeing	147.2	110.4	16.0	17.0
General Electric	112.1	48.3	7.0	7.4
Kaiser Engineers	65.0	48.8	7.1	7.5
Mack Trucks	40.0	30.0	4.3	4.6
SEDCO	31.5	23.6	3.4	3.6
U.S. Steel	24.5	18.4	2.7	2.8
Hunter Engineering[2]	16.0	12.0	1.7	1.8
TAMS[2]	11.3	8.5	1.2	1.3
Kaiser Aluminum Tech. Ser.	10.0	7.5	1.1	1.2
Enserch Corp.	8.8	5.7	0.8	0.9
Fuller Co.	8.6	6.4	0.9	1.0
McDermott	8.6	6.1	0.8	0.9
Dresser Industries	7.5	3.2	0.5	0.5
Westinghouse	6.5	3.6	0.5	0.6
Peerless Pumps	5.8	4.4	0.6	0.7
Bechtel	5.5	4.1	0.6	0.6
Continental Emsco	3.5	2.6	0.4	0.4
Gardner-Denver	3.0	2.3	0.3	0.4
TOTAL	1,147.5	614.9	88.8	94.6

1) Ranked according to export value.

2) Small business.

*It is not always possible to immediately identify the equipment suppliers under Exim's direct loans, as specific procurement decisions may not be made until some time after the loan is authorized. Thus, this column is based on only the "identifiable" exporters in each fiscal year.

TOP 20 EXIM USERS--1982
Direct Credits Only

COMPANY[1]	EXPORT VALUE ($ mil.)	CREDIT VALUE ($ mil.)	PERCENT OF CREDITS AUTHORIZED Total (%)	PERCENT OF CREDITS AUTHORIZED Identified* (%)
General Electric	480.2	291.4	10.4	13.5
Allis-Chalmers	297.4	251.7	9.0	11.7
Boeing	249.9	117.4	4.2	5.4
Fluor Corp.	240.0	155.9	5.6	7.2
Morrison-Knudsen	194.0	145.5	5.2	6.7
General Motors	111.6	63.4	2.3	2.9
WABCO	110.0	82.5	3.0	3.8
McDonnell Douglas	98.5	40.2	1.4	1.9
Babcock & Wilcox	96.0	64.2	2.3	3.0
Westinghouse	87.1	50.6	1.8	2.3
Great Lakes Dredge & Dock	72.6	54.5	2.0	2.5
Johnson Brothers Corp.	69.4	52.1	1.9	2.4
United Technologies	68.8	38.3	1.4	1.8
Kaiser Engineers	60.0	45.0	1.6	2.1
Lancaster Steel	43.7	31.1	1.1	1.4
Chemtex	41.2	19.2	0.7	0.9
USS Oil Well Supply	40.5	26.3	0.9	1.2
Hughes Aircraft	40.0	27.6	1.0	1.3
Fuller Co.	39.9	30.0	1.1	1.4
Davy McKee	33.0	14.0	0.5	0.6
TOTAL	2,373.8	1,600.9	57.3	74.2

[1] Ranked according to export value.

*It is not always possible to immediately identify the equipment suppliers under Exim's direct loans, as specific procurement decisions may not be made until some time after the loan is authorized. Thus, this column is based on only the "identifiable" exporters in each fiscal year.

TOP 10 U.S. EXPORTERS USING THE DIRECT LOAN PROGRAM
Fiscal Years 1979 - 1981
(all $ values shown as millions)

Exporter	Export Value Supported by Direct Loans	Exim Direct Loan Value	Direct Loan Value As A Percent of Direct Loans Authorized	
			Total	Identifiable
FY 79				
1. Boeing	$ 1,971	$ 979	25.6%	30.6%
2. McDonnell Douglas	742	313	8.2	9.8
3. Westinghouse	528	483	12.6	15.0
4. Foster Wheeler	484	370	9.7	11.6
5. General Electric	155	91	2.4	2.8
6. Morrison-Knudsen	109	47	1.2	1.5
7. The Fuller Co.	74	56	1.5	1.7
8. Combustion Engineering	71	53	1.4	1.7
9. General Motors	65	29	0.8	0.9
10. United Technologies	50	32	0.8	1.0
Total	$ 4,249	$ 2,453	64.2%	76.6%
Various/unknown	$ 1,040	$ 624	16.3%	
FY 80				
1. Boeing	$ 2,147	$ 836	10.6%	22.4%
2. McDonnell Douglas	925	411	10.2	11.1
3. United Technologies	691	279	6.9	7.5
4. General Electric	529	287	7.1	7.7
5. Westinghouse	510	216	5.3	5.8
6. Western Electric	344	198	4.9	5.3
7. Lockheed	277	213	5.3	5.7
8. Combustion Engineering	206	111	2.7	3.0
9. Hughes Commercial Int'l.	150	98	2.4	2.6
10. Allis-Chalmers	126	88	2.2	2.4
Total	$ 5,905	$ 2,737	67.6%	73.5%
Various/unknown	$ 664	$ 319	7.9%	
FY 81				
1. Boeing	$ 3,100	$ 1,769	35.1%	43.4%
2. United Technologies	951	601	11.9	14.7
3. General Electric	487	357	7.1	8.8
4. Lockheed	377	107	2.1	2.6
5. Western Electric	297	253	5.0	6.2
6. Westinghouse	171	95	1.9	2.3
7. McDonnell Douglas	144	66	1.3	1.6
8. Pullman Kellogg	81	63	1.2	1.5
9. Dresser Industries	79	52	1.0	1.3
10. General Motors	78	44	1.9	1.1
Total	$ 5,765	$ 3,407	67.5%	83.5%
Various/unknown	$ 1,518	$ 970	19.2%	

Senator Heinz: Several years ago, the private insurance companies involved in FCIA -- the Foreign Credit Insurance Association — made a decision to withdraw from that consortium and discontinue underwriting any export credit risks through FCIA. Since then, private insurance companies have entered the export credit insurance business on their own. What steps is Eximbank taking to ensure that the U.S. government does not displace private insurers or underprice them, particularly with respect to transactions in the less risky markets or insurance policies designed for the larger U.S. exporters? How does Exim plan to monitor future developments in the private export credit insurance market to ensure that, as private market capacity expands or contracts, Exim responds appropriately? Finally, since private-sector insurance companies are no longer involved with FCIA and it is now solely a government operation, what is Exim's justification for maintaining the FCIA corporate structure (e.g., separate management, New York City office, operational units which duplicate Exim's).

Mr. Draper: First, let me address two points in the question. FCIA is still an association of private insurance companies operating under a reinsurance agreement with Eximbank. Well known insurers are members: Hartford Accident and Indemnity Co., American Credit Indemnity Co., Liberty Mutual Insurance Co., and The Travelers Indemnity Co. Officers of two of these private companies are members of the FCIA Board of Directors and attend meetings on a regular basis, providing us with input on the state of the private export credit insurance market.

Second, there is minimal duplication between organizational structure in FCIA and Eximbank. Instead, the organizations are complementary. FCIA's underwriters operate under defined authority. Their staff also handles certain administrative, collection, and marketing aspects of the business. At Eximbank we have only 12 loan officers and a very small support staff in the insurance division which handles the special facilities and presents larger cases to the Board of Directors.

We expect to underwrite about $7.5 billion of foreign credit insurance this fiscal year. The insurance support has been critical to certain countries, covering some 60% of all U.S. exports to Nigeria in 1985, for example. It has been particularly useful to small businesses and the exporters of American agricultural products. FCIA insurance is predominantly used to cover shipments to the more troubled economies.

Although some private insurers are underwriting foreign commercial and political risks, their capacity, to the best of our knowledge, is extremely limited and not in conflict with the underwriting and pricing practices of FCIA. Their experience has been not unlike that of commercial banks, and they are similarly risk averse.

Our goal is to have the private sector handling as much of this business as they are willing to handle competitively for American exporters. However, it is important to the national interest of providing risk protection competitive with that of other nations that Exim continue to underwrite reasonable risks that private insurers are unwilling or unable to take. We are working hard, and in consultation with private sector insurers, to ensure that we have the most efficient way to accomplish this objective.

Emergency Committee for American Trade 1211 Connecticut Ave Washington DC 20036 (202)659-5147

March 26, 1986

Mr. Edward Malan
Editor
United States Senate
Committee on Banking, Housing
and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Malan:

Mr. Axel Velden testified before the Subcommittee on International Finance and Monetary Policy on the hearing on the Charter of the Export-Import Bank.

Enclosed are the responses of Mr. Velden to the written questions submitted by Senator Sasser. I understand that Mr. Velden's responses will be included in the written record of the hearing.

I am also enclosing the original questions of Senator Sasser.

Sincerely,

Calman J. Cohen
Vice President

cc: Axel Velden
Nick Ruggieri

ADDITIONAL QUESTIONS OF SENATOR SASSER

MR. VELDEN:

I AM INTERESTED IN SOME ADDITIONAL DETAILS ON YOUR TESTIMONY CONCERNING THE ROLE EXPORTS WILL HAVE TO PLAY IN CONTINUING THE U.S. LEAD IN ADVANCED MEDICAL TECHNOLOGY. YOU REFERRED TO THE BRAZILIAN PROJECT COORDINATED BY JOHNSON & JOHNSON, INCLUDING 40 EQUIPMENT MANUFACTURERS. I EXPECT THAT REPRESENTS QUITE A NUMBER OF JOBS WITHIN THOSE 40 MANUFACTURERS.

DO YOU HAVE AN ESTIMATE ON THAT?

I WOULD ALSO LIKE FOR YOU TO EXPAND ON YOUR STATEMENT THAT THE PACKAGE REPRESENTED MILLIONS OF DOLLARS IN RESEARCH AND DEVELOPMENT COSTS THAT CAN NOT BE RECOVERED IN U.S. SALES ALONE, ESPECIALLY IN LIGHT OF YOUR FURTHER STATEMENT THAT "MEDICAL TECHNOLOGY OFFERS A UNIQUE OPPORTUNITY FOR EXPORT GROWTH BECAUSE IT IS AMONG THE LAST AREAS IN WHICH THE U.S. ENJOYS WORLD LEADERSHIP."

IN ADDITION TO YOUR ROLE AS DIRECTOR OF THE EXPORT DIVISION FOR JOHNSON & JOHNSON, BUT YOU ALSO REPRESENT THE EMERGENCY COMMITTEE FOR AMERICAN TRADE.

THE U.S. SHARE OF HIGH-TECHNOLOGY EXPORTS TO WORLD MARKETS HAS DROPPED PRECIPITOUSLY IN THE PAST TWO DECADES. WHAT IS DIFFERENT ABOUT MEDICAL TECHNOLOGY? WHAT WILL IT TAKE TO GENERATE MORE SUCCESS STORIES LIKE THE ONE YOU HAVE RECOUNTED?

RESPONSES TO SENATOR SASSER

A. The Department of Commerce estimates that every billion dollars worth of exports supports 25,000 domestic jobs on the average. Using that base tabulation, we estimate that the $40 million represented by the Brazil project coordinated by Johnson & Johnson, would support 1,000 jobs domestically.

A. In our prepared statement, we indicated that Johnson & Johnson secured approval for magnetic resonance technology in diagnostic imaging in 1984. The amount of research investment represented by that approval is in the neighborhood of $70 million. Johnson & Johnson cannot foresee a recovery of that investment within the domestic market alone. One reason for this is the fact that the domestic market is subject to very elaborate and severe health care cost containment pressures. Therefore, it is necessary to seek worldwide markets for this very expensive equipment to achieve profitability, particularly since the rapid advance of technology will probably give this equipment a relatively short economic life.

We based our statement concerning leadership in this technology on the fact that our potential customers

overseas have indicated a distinct preference for the state-of-the-art American equipment. We also believe that the medical/academic community will support the view that the cutting edge of technology in diagnostic imaging and critical care monitoring lies in the United States and not elsewhere. We are not aware of many other high-technology areas where the United States holds undisputed leadership. There may well be other areas, but the point is that we could lose this leadership very quickly if we allow the competition to take over the dominance of the export market.

A. We cannot be specific about the extent to which U.S. high-technology exports have declined in recent years, but the semiconductor field is a good example of our loss of leadership. We believe there are many reasons that account for this, including the policy problems that come up whenever the export of high-technology is involved, such as restrictions imposed on exporters by the Commerce Department, the State Department and/or the Defense Department. Another reason, of course, is the fact that the export credit agencies of other countries are equally desirous of exporting their own technology and are quick to grant financing concessions.

Medical technology presents unique circumstances because it involves equipment that is designed for life-saving purposes; therefore, it has humanitarian value and often receives priority attention in the export markets. However, cost is a major factor.

The export credit policies of other countries perceive those conditions much more quickly than in the United States and consequently have, in cases such as Brazil, been able to capture a market previously dominated by the United States, notwithstanding the fact that the U.S. equipment is superior.

We think one way to improve upon the few success stories that have been generated so far would be for Eximbank to increase the use of mixed credits to enable U.S. exporters to overcome the predatory financing practiced in other countries. Beyond that, exports in the health care field could be helped if Congress and others recognize the special circumstances that exist in this area and then develop an export policy that will result in greater opportunity for financing support for potential overseas customers. An example of how this might be translated into action would be for the U.S. to focus attention on medical technology in deliberations at the World Bank, the

Inter-American Development Bank, the Agency for International Development, the United Nations, the World Health Organization, and any other agencies public and private that have economic support for the Third World as a primary mission.

We think the same story could be told in other industrial areas where U.S. technological capability is in demand overseas. We simply believe that the medical field provides one good possibility for the policymakers to recognize the scope of U.S. export potential.

ADDITIONAL QUESTIONS OF SENATOR SASSER

MR. WILLIAMS:

YOU HAVE ALREADY ARRIVED AT A FIGURE FOR THE 1986 TRADE DEFICIT IN MANUFACTURED PRODUCTS. YOU INDICATE THAT IT WILL BE AROUND $110 BILLION, ABOUT THREE-QUARTERS OF THE TOTAL. THAT MEANS YOU ESTIMATE NO PROGRESS THIS YEAR, OVER THE 1985 DEFICIT OF $148.5 BILLION.

WHY NOT?

HOW MUCH LAG TIME IS THERE BETWEEN A MAJOR CHANGE -- SUCH AS THE DROP IN THE DOLLAR -- AND ITS EFFECTS IN THE COMMERCIAL MARKET?

HOW MUCH LONGER ARE WE GOING TO BE SEEING THE LINGERING EFFECTS OF THE DOLLAR'S VALUATION OVER THE PAST COUPLE OF YEARS?

CATERPILLAR TRACTOR CO.

Vice President

Peoria, Illinois 61629

March 25, 1986

Mr. Edward M. Malan
Editor
Committee on Banking, Housing, and Urban Affairs
SD-534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Malan:

I was pleased to have the opportunity to testify on the Export-Import Bank before the Subcommittee on International Finance and Monetary Policy. This letter responds to Senator Sasser's additional questions, copy attached.

Despite the recent depreciation in the value of the dollar against many other currencies, we do not believe the 1986 current account deficit will decline significantly.

Some reasons are straightforward. For example, many American purchasers have longer-term import contracts, which are maintaining a flow of goods into the United States. And because the dollar rose so sharply in late 1984/early 1985, some harmful effects had not yet appeared by the time the dollar started to fall last year. As those later, negative effects have materialized, they have tended to offset initial positive impacts of the dollar's decline.

Other important reasons are more complex and relate to the fact the dollar was highly overpriced for so long.

The sustained dollar overvaluation allowed many foreign companies to have both low prices and large profit margins on their exports to the United States. With the depreciating dollar, many foreign firms have reacted by allowing their profit margins to shrink instead of by raising prices. But even if they are earning less on their U.S. sales, their sales volumes are staying at relatively high levels. We hear of price increases coming, but to date these have not passed on to the transaction levels. In the limited cases where price increases have been announced, they have been offset completely by special marketing programs of equal or greater value. I have attached, for the Committee's use, a March 7 memo prepared by a division of Merrill Lynch, which describes the pricing situation we presently face.

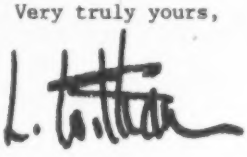
CATERPILLAR TRACTOR CO.

The overvalued dollar also forced many U.S. manufacturers to make fundamental changes in the way they do business. Among these changes was a significant shifting of operations and purchasing to sources outside the United States. These sourcing actions cannot be reversed quickly; even if they could, it would not be prudent to do so until it becomes clear that the recent correction in the dollar's value will be sustained.

These complex factors make it difficult to predict how long the negative effect of the dollar's overvaluation will linger. Most econometric studies predict there will be 12 to 18 months between a currency's depreciation and the time when it begins to be reflected in the country's trade picture. We believe that emphasizes the need to keep the pressure on our trading partners and ourselves -- to sustain currency rate alignments needed to correct U.S.' trade imbalances. Needless to say, we are tracking the situation in our industry very closely and would be pleased to submit additional information later in the year as the facts unfold.

I believe this responds to Senator Sasser's questions.

Very truly yours,



LWilliams
Telephone: (309) 675-5126
pld/683313

Attach.

cc: Senator James R. Sasser

Merrill Lynch Capital Markets

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One Liberty Plaza
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212 637-6000

Alex Blanton

March 7, 1986

PRICING TRENDS IN CONSTRUCTION EQUIPMENT - CRITICAL VARIABLE IN CATERPILLAR EARNINGS AND MARKET SHARE - NEW KOMATSU STRATEGY

Our analysis of pricing in the construction equipment market shows the following:

1. Industry conditions should allow enough increase in price realizations this year to add comfortably to Caterpillar's earnings, while putting serious pressure on Komatsu's bottom line.

2. Caterpillar (51) is unlikely to increase list prices soon, because increased price realizations from Europe (the lower dollar against sales made in local European currencies) combined with lesser dealer discounting (lower charges to earnings from CAT's Participatory Discount Program (PDP)), and further cost reductions throughout 1986 should result in significantly higher earnings by themselves.

3. The need for Komatsu to increase prices is putting pressure on Komatsu and its dealers, and could lead to some weakening of its distribution system.

4. Caterpillar dealers are likely to use their sudden price advantage to go for market share on many deals.

5. Komatsu is likely to change its product and marketing strategy - it may bring out a second line of simpler, less expensive machines (and of lower quality) that would compete in the price sensitive part of the market instead of with Caterpillar equipment.

KOMATSU IN A QUANDARY

Komatsu does not yet know what it should do. Its plans for 1986 were based on a dollar equal to 200 yen. At a dollar equal to 180 yen, it needs a new strategy, which it is groping toward. If the dollar falls to 160-170 yen, as Komatsu now fears, then its position will be even tougher.

Komatsu America is having difficulty passing along the company's November price increase to its dealers.* Its dealers are complaining bitterly and are clamoring for bigger discounts; we believe that Komatsu has been granting some

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*The November increase by Komatsu Ltd. was 5-10% on all dollar contracts (an average of 7%), effective November 1 (with 60-day protection for existing orders). Komatsu America raised prices to its dealers by 3-7% at that same time.

of those discounts. Caterpillar, for its part, is saying that Komatsu has not really raised prices - that it is offsetting those increases with larger discounts. Even if that is so, however, Komatsu America must pay the higher price to its parent, Komatsu Ltd., and we understand that Komatsu America lost money in November and December - approximately $1.6 million.

Komatsu Ltd. is also getting pressure from its foreign distributors who buy from it in yen (about half of Komatsu's exports are in dollars and about half in yen). Those distributors are also asking for bigger discounts when their local currency translates into fewer yen.

Komatsu America has not yet passed along the parent company's second price increase (a 3-7% increase by Komatsu Ltd. on all dollar contracts effective February 21 (an average 5%)).* It is trying to decide how to do that. Last week, the President of Komatsu America cancelled a trip to New York City because an Executive Managing Director of Komatsu Ltd. flew in from Tokyo on short notice to meet with Komatsu America on that subject.

Komatsu Ltd. must raise its prices or face a severe decline in its profits. Komatsu Ltd's profit margin before the dollar declined was about 8% pretax, most of which was earned in the export market. The dollar is now down against the yen by 25% from July and August, by 28% from the second quarter of last year and by 30% from the first quarter of last year. Komatsu hedged 80% of its 1985 profit in the forward currency markets at dollar equal to 235 yen, and has hedged half of its 1986 first-half profit at that level as well. Beyond the first half, however, Komatsu would need a major price increase to maintain profits at former levels.**

Another reason that Komatsu Ltd. must increase its prices is anti-dumping laws. If Komatsu's costs go up as the yen goes up, then its selling prices must be adjusted when those prices fall below Komatsu's cost levels.

The reason that Komatsu America doesn't know what to do is that the complaints from its dealers already are very big. It feels that it can't discount more because of the yen appreciation, but says that its dealers don't think about the yen. Its dealers are simply telling Komatsu that they can't pass the increases along and need bigger discounts, primarily because Caterpillar hasn't raised prices.

Caterpillar, of course, is saying that it will not raise its prices until transaction prices in the market go up, and most of the CAT dealers are telling CAT that prices are not rising because Komatsu is not sticking to its price increase, but merely giving bigger discounts.

We suspect that the real reason that prices aren't going up is that in this economy, no one is going to raise prices by 12%, no matter what the product - the market won't stand for it.

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*The increase was 7% on larger models down to 3% on smaller models, and so may have averaged more than 5% on a dollar basis.

**Komatsu America did not, however, "quietly" tell its dealers that its prices would rise between 15% and 20%, as reported by the WSJ on February 14. What it said was that the yen might appreciate by another 15% to 20% (from dollar equals 192 yen at that time).

CATERPILLAR'S APPARENT STRATEGY

Because it knows that large price increases are not possible, Caterpillar's strategy seems to be to let its dealers decide what the prices should be on a deal by deal and a market by market basis.

The spread between the discounted market prices and Caterpillar's list price is about an estimated 12%. In strong markets, CAT's dealers are free to discount less than they have been, and in weak markets to continue with larger discounts. On some deals, dealers may be able to get better prices from solid customers. On other deals, they can go after Komatsu's customers with heavier discounts. Caterpillar will get some price relief from any lower discounts through lower discount sharing with its dealers (about 1/2 of the dealer discounts above a certain minimum are rebated to the dealer from the company and charged to CAT's sales and earnings).

If, on the other hand, Caterpillar were to raise its list price significantly, that action would raise the price in all its markets and for all its customers across the board, whether weak or strong. Thus Caterpillar would be forced to offer bigger discounts in many markets and to many customers just as Komatsu America is doing.

With its current strategy, it seems to us that Caterpillar puts pressure on Komatsu, preserves its pricing options, picks up market share here and there, and takes advantage of the fact that Komatsu dealers do not have the flexibility to discount as they once did.

The pressure on Komatsu dealers has only begun, in our opinion. As indicated by the trend of industry orders below, Komatsu dealers ran down inventory in October and November, and reordered strongly in December. Komatsu America dealers have 3 to 5 months of inventory because of the long pipeline, and Komatsu America has another four months of inventory in staging areas and on

CONSTRUCTION MACHINERY ORDERS - NORTH AMERICA TO JAPAN
(Millions of Yen)

	1985	1984
Jan	11,315	-
Feb	7,702	-
Mar	15,088	-
Apr	19,319	-
May	16,092	-
Jun	11,694	-
Jul	14,650	16,681
Aug	16,451	11,185
Sep	14,490	14,375
Oct	6,630	13,951
Nov	8,560	16,550
Dec	17,263	5,671

Source: Machinery Export Association of Japan

the ocean coming from Japan.* So it takes awhile for the price increases to be felt. Komatsu dealers are still selling some of their old inventory at old prices. The equipment ordered in December will be coming in soon, however, and will carry higher list prices. Note that total fourth-quarter orders were down 10% from a year earlier, indicating a lower overall level of business for Japanese importers.

We do think, however, that there is room for modestly higher price realizations in CAT's markets this year. The forecasts in the next section assume a 5% year-to-year price increase for 1986, about one-half of which was already realized in the fourth quarter of 1985, according to our estimate. Here is why we think that there can be higher transaction prices in 1986.

1. We believe, and Komatsu agrees, that at dollar equals 180 yen, the grey market, which has depressed the selling prices, is on the way out once its current inventory of old equipment is sold. Dealers are seeing very little, if any, new equipment in the hands of grey marketeers. We expect the grey market to be gone soon, and that means a reduction in the supply of equipment relative to demand. Komatsu says that 90% of its dealers at the Komatsu dealer meeting in January complained about the grey market.

2. We expect that in strong markets there will be less discounting, particularly during the spring and summer seasonal upswing in demand that is now just beginning. For example, one mid-west CAT dealer in a market that was up 20-25% last year and up again in early 1986, told us that his Komatsu counterpart was raising prices by 10-15% on new items ordered from Komatsu, while continuing to sell items from his inventory at the old prices. That was the exception however. Six out of eight CAT dealers we spoke with recently said transaction prices were currently stable.

3. This year, prices could be helped by the possible UAW strike at Caterpillar on June 1. Dealers are building strike-hedge inventories, which inventories would tend to become more valuable as the June 1 deadline approaches, we would think. If there should be a strike, then equipment shortages could help push up prices for a while.

4. As previously mentioned, the decline in the dollar against European currencies has meant that Caterpillar's sales in local currencies in Europe translate into more dollars, giving CAT a higher price realization. Caterpillar has calculated that every 10% decline in dollar against European currencies adds $100 million to its pretax earnings annually.

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*Komatsu-America's sales in 1985 were about $425 million, short of its $450 million target, but well up from $309 million in 1984. Part of the increase, however, was a buildup of dealer inventory of new models and new lines of products as Komatsu America expanded its breadth of offerings in the United States.

NEW KOMATSU STRATEGY

Komatsu is definitely seeking to define a new strategy. One option that is open is to take cost out of the product.

Until now, Komatsu has sought to compete head-on with Caterpillar. Komatsu has presented itself as the alternative supplier of quality equipment at a lower price. However, last December Komatsu Ltd.'s president, Shaji Nogawa, said that "I am not all that interested in being number one or number two," and indicated that the company was backing away from an all-out, cutthroat battle for market share. ("Komatsu Calls for a Ceasefire," Financial Times of London, December 4, 1985.)

We think that beyond dealing with the current question of how to adjust its prices, that eventually Komatsu will move to introduce new lines of simpler, less expensive equipment that will cost substantially less to make but that will also require in a change in its marketing emphasis. Such a "popularly priced" line would not have much appeal for the traditional buyer of Caterpillar equipment, in our opinion. It would take Komatsu away from going aggressively after CAT, and redirect some of its sales thrust into the price sensitive market against Deere (34), Case, Fiat Allis, and Dresser (International) (18).

The strategy of offering less expensive, simpler, and sometimes lower quality equipment has been used by the Japanese successfully in the machine tool and in the lift-truck markets, and is the logical strategy for Komatsu to follow, in our judgment. But keep in mind that Caterpillar has been competing for many years against companies who have done that very thing. There is a very large market for lower quality, lower priced equipment, which is why Caterpillar only has about 40% of the total market.

EXPECTED PRICE REALIZATIONS FOR 1986

The following is our index of Caterpillar's price realizations by quarter and for the full year, using the second quarter of 1984 as a base of 100.

ESTIMATED INDEX OF CATERPILLAR PRICE REALIZATIONS
(Second Quarter 1984 Base of 100)

	1st Q	2nd Q	3rd Q	4th Q	Full-Year Average	Full-Year Year-to-Year Change
1986E	102.5	104.0	104.0	104.0	103.7	+5.0%
1985	99.0	97.9	97.0	101.4	98.8	+1.3%
1984	97.2	100.0	97.0	95.8	97.5	

Notice that CAT's fourth-quarter price realization last year was already up 4.5% from the third-quarter level and up 2.6% from the full-year average. Thus it would require only a further 2.6% change in price realization from the fourth quarter to push the index to 104 and to give CAT a 5.0% overall increase in price realization from 1985. Such a 5.0% increase would add an estimated $2.30 a share to CAT's earnings on a fully-taxed basis, and is incorporated in our estimate of $5.00 a share for Caterpillar this year.

The increase in CAT's price realization in the fourth quarter of last year came from (1) greater price realizations from sales made in European currencies because of the declining dollar, (2) slightly less discounting, and (3) a better sales mix - the absence of large shipments to Turkey and China, which we believe went out at low prices because those contracts were bid in earlier months when the dollar was strong.

The increase in CAT's price realization in the fourth quarter added an estimated $78 million to CAT's sales and pre-tax earnings from the third quarter level. That increase in profit was partially offset by the negative effects of a decline in the physical volume of shipments of $79 million, which reduced pre-tax earnings by an estimated $31 million (39% of $79 million). Because of negative year-end adjustments, cost reduction in the quarter (from the prior quarter) was zero, so the net effect of higher prices and lower volume was a $47 million increase in operating profit from the prior quarter, as shown below.

ESTIMATED EFFECTS OF PRICES, COSTS AND VOLUME
ON CATERPILLAR OPERATING PROFIT
(Millions of Dollars)

	1985		1986E	
	3rd Q	4th Q	1st Q	2nd Q
Sales	1,806	1,805	1,820	2,150
Constant Dollar Sales (Third-quarter Dollars)	1,806	1,727	1,722	2,005
Changes in Sales Dollars from the Prior Quarter				
Price Realization		+78	+20	+ 47
Physical Volume		-79	- 5	+283
Total		- 1	+15	+330
Changes in Operating Profit from the Prior Quarter				
Price Realization		+78	+20	+47
Cost Reduction		-0-	+32	-0-
Physical Volume Related		-31*	-2*	+113*
Total Change in Operating Profit		+47	+50	+160
Plus Prior Quarter Profit		3	50	100
Current Quarter Operating Profit		50	100	260

*Approximately 40% of the change in physical volume from the prior quarter.

In the first quarter of 1986, we expect a further $20 million increase in price realization to result from the full effect of the prior quarter's dollar decline against European currencies, plus the additional dollar decline in the first quarter, plus lower discounting. We also estimate that the absence of year-end cost adjustments, plus further cost reduction will add another $32 million to earnings, raising total operating profit to $100 million from $50 million in the fourth quarter.

A similar approach yields an estimated $260 million operating profit in the second quarter, given our price index of 104. That estimate assumes no cost reduction from the prior quarter. Of the $160 million increase in profit from the first quarter, an estimated $113 million comes from higher physical volume, which will be inflated by strike-hedge buying.

Obviously, such second-quarter sales and earnings would borrow from the third quarter, which we would expect to decline from the second quarter to about $100 million in operating profit again.

Caterpillar will be helped in 1986 and beyond by new products. As befits the industry leader with the strongest finances, Caterpillar spent $326 million in 1985 and over $1 billion in the past three years on R&D and new products, and brought out in 1985 the biggest array of new products in the company's history. Many more new products are being introduced in 1986 (see page five of Caterpillar's new annual report).

We continue to estimate $5.00 a share for Caterpillar for 1986, $6.00-7.00 a shre for 1987, and to rate the shares Buy (1) on both an intermediate and long term basis. Our estimate does not include any negative effects from a possible strike.

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Additional information is available upon request.

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MLPF&S was a manager of a public offering of securities of Caterpillar Tractor within the last three years.

The information set forth herein was obtained from sources which we believe reliable, but we do not guarantee its accuracy. Neither the information, nor any opinion expressed, constitutes a solicitation by us of the purchase or sale of any securities or commodities.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR MATTINGLY FROM

WILLIAM H. DRAPER III

Senator Mattingly: Are private lenders now capable of and interested in providing the volume of funds necessary to meet U.S. exporters' needs under the I-MATCH proposal? What changes have been made since last year to accomplish this?

Mr. Draper: Private lending institutions are now capable of and interested in providing the volume of funds needed for I-MATCH. The presently proposed I-MATCH program differs from the FY 1981 I-MATCH proposal in two key respects.

1. Eximbank's guarantee would be more freely transferable.
2. Financial institutions would not be required to take the interest rate risk of "warehousing" undisbursed funds during an extended disbursement period.

Senator Mattingly: What premium over Treasury rates are private lenders likely to charge under the long-term I-MATCH program?

Mr. Draper: The premiums will vary from case-to-case and from time-to-time, but will probably range from 30 - 100 basis points over a comparable Treasury issue.

Senator Mattingly: If Exim's net worth continues to decrease as the Bank makes I-MATCH payments to lenders, how will this impact Exim's ability to function, to garner public support, and to negotiate away export credit subsidies with its foreign counterparts?

Mr. Draper: The I-MATCH program would not significantly increase the rate of decrease of Exim's net worth, as any subsidies now contained in our present direct credit program also must come from our reserves. Regardless of the level of our net worth, Exim can continue to borrow from the Federal Financing Bank to meet its obligations under its charter.

Senator Mattingly: To what extent are U.S. manufacturers losing sales in the United States to imports from newly industrialized countries like Korea and Brazil, primarily because of the attractive credit terms made available from these sellers' governments?

Mr. Draper: Because there is no formalized system for these countries to report their actual commitments, it is difficult to determine the volume of U.S. imports financed from Brazil and Korea during the last few years. However, information obtained during 1984 indicates that two U.S. import sales were financed by Korea and Brazil with a total import value of $130 million. The Brazilian export involved the sale of 10 Brasilia aircraft financed in U.S. dollars at eight percent over 10 years totaling $100 million. The Korean export involved the sale of drilling rigs totaling $30 million financed in U.S. dollars at nine percent over seven years.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM

WILLIAM H. DRAPER III

Senator Proxmire: You stated at the February 7 hearing that during your tenure as Chairman the Export-Import Bank has "never made a loan commitment or a guarantee where we have not felt that in the long run there is a reasonable assurance of repayment."

On December 12, 1984, however, the Board of Directors formally approved making a preliminary commitment to the government of Egypt to provide loans or loan guarantees totalling $225 million in order to assist in financing a 1,000 MW nuclear plant in Egypt. The Board in making that loan decision found it could not comply with the requirement in its charter that there be a "reasonable assurance of repayment". Therefore it made the loan commitment under the Bank's special Export Expansion Facility which allows a lesser probability of repayment. I understand that the Board took this extraordinary step, after first denying the loan three times, because there was pressure from the White House, the State Department, and Westinghouse to approve that loan.

Given the current financial condition of the Bank, and the large number of exporters seeking assistance who can satisfy the reasonable assurance of repayment -- do you think we should allow 12 USC 635(j) of the Bank's charter to remain on the books in its present form, or do you think additional statutory safeguards are needed to ensure the Bank does not dissipate its limited resources for political purposes?

Also, given the questions raised by Eximbank staff about Egypt's ability to repay the proposed loan, is the Bank justified in making it even under the lesser standard of repayment governing the use of the now infrequently used Export Expansion Facility?

Mr. Draper: In deciding to approve a preliminary commitment for the Egyptian nuclear plant, Exim's Board of Directors took into account the particular importance of this sale to the long term interests of the United States, as well as assurances from the Egyptian Government that charges for electric power from this plant would be at unsubsidized rates. After considering these factors, our Board found that the transaction offers sufficient likelihood of repayment to justify the Bank's support. The Bank has utilized the Export Expansion Fund (12 USC 635(j) sparingly and does not think that additional statutory safeguards are required.

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